

COLLEGE



LAW

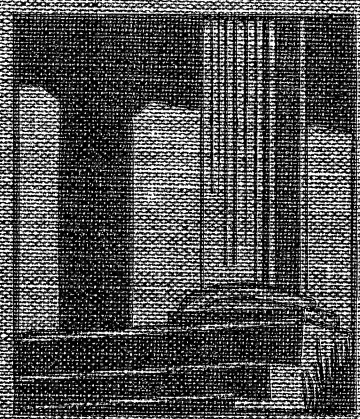
CHARLES

Fourth  
Edition



SOUTH-WESTERN  
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LCC

COLLEGE



LAW

A. ALDO CHARLES

Fourth Edition

# COLLEGE LAW

*By*

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## PREFACE

The old proverb, "Experience is the best teacher," may be true but experience certainly is not the cheapest. The objective of every course in business law should be to substitute the unfortunate experiences of others for the student's own experience. In the final analysis education is primarily vicarious experience. The teacher must create a situation in which the student can readily visualize himself as one of the participants. The text must aid the teacher in creating this situation. This has been the dominant aim of the author throughout this revised edition.

Every case recorded in this text is merely an historical record of the business dealings of two or more people. In practically every instance a knowledge of some simple legal principle would have avoided these unfortunate experiences. In law, as well as in war, even the winner more often than not loses when recourse must be had to the courts to settle disputes. The aim should be to equip the student with those legal principles which will enable him to avoid the common errors that others have made. But no attempt has been made to discuss every legal principle known to man. To do so would only confuse rather than enlighten the student. The task of learning all of them would overwhelm him.

You will observe in the cases how often a secretary or an accountant through some inexcusable error loses money for his employer. Often under the law of agency the secretary or the accountant must make good this loss out of his own personal funds. Such a vicarious experience will not only teach the student business law; it will also inspire him to be a better secretary or accountant as well. Two or three case problems of this type are worth a dozen problems that are wholly beyond the imaginary experience of the average college student. The average young person of college age cannot visualize

himself as playing a vital part in a dispute between the United States Steel Corporation and the Chase City National Bank. The legal principle involved in litigation between these two economic giants might be the same as that between John Doe and Richard Rowe over a television set, but the latter experience is far more meaningful because every college student can visualize himself as being one of the participants. It is this type of case problem that dominates this book.

The new edition has retained all those features of the old editions that have proved to be so popular with teachers in the past. All the material in each chapter is developed in logical sequence. A text reflects the teaching techniques of the author. In a quarter of a century of teaching business law the author has through trial and error developed techniques that are sound. He has attempted to portray these techniques in this text. Many of his most important methods have been acquired through association with his fellow teachers. By sharing our experiences and ideas we can all grow professionally right on until the age of retirement.

The author is indebted to his colleagues at the University of Georgia for their many helpful suggestions. He is also deeply indebted to many teachers who have written in the past with helpful comments for this revised edition.

A. A. C.



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**Part V**  
**NEGOTIABLE**  
**INSTRUMENTS**



## CHAPTER XIX

### DEVELOPMENT OF NEGOTIABLE INSTRUMENTS

*"To investigate is the way to know what things  
are really lawful."*

**FOREWORD.** The term *negotiable instruments* simply means *negotiable contracts*. This and the following chapters deal with this type of contract. The first task is to learn the meaning and the significance of negotiation, and secondly, the classes of instruments that qualify as negotiable contracts. This chapter deals specifically with these two phases of the problem. It also gives a brief history of the origin and development of negotiable contracts and the difference between negotiability and assignability discussed in Chapter IX.

**What Is a Negotiable Instrument?** A *negotiable instrument* is a written contract drawn in a special form, which can be transferred from person to person as a substitute for money or as an instrument of credit. To serve as a substitute for money, however, such an instrument must meet certain definite requirements in regard to form and the manner in which it is transferred. It should be noted that since a negotiable instrument is not actual money, a person is not required by law to accept one in payment of a debt due him unless he wishes to do so.

**History and Development.** "Necessity is the mother of invention" is a quotation often repeated. It is especially appropriate to negotiable contracts of credit. In the days of sea pirates and land robbers the shipment of money in settlement of debts between traders was a risky business. The need for instruments of credit that would permit the settlement of claims between distant cities without the transfer of money has existed as long as trade has existed.

There were references to bills of exchange or instruments of credit as early as 50 B.C. Their widespread usage, however, began about 1200 A.D. At first these credit instruments were used only in international trade, but they gradually became common in domestic trade.

Prior to about 1400 A.D. all disputes between merchants were settled on the spot by special courts set up by the merchants. The decisions of these courts became known as the *law merchant*. Later the common law courts of England took over the adjudication of all disputes including those between merchants, but these common law courts retained most of the customs developed by the merchants and incorporated the law merchant into the common law. Most, but by no means all, of the law merchant dealt with bills of exchange or credit instruments. The colonists brought these laws to America. After the Revolution each state developed the common law dealing with credit instruments in its own way so that by 1890 much confusion existed by reason of the multitude of laws dealing with negotiable contracts. In 1895 a commission was appointed by the American Bar Association and the American Bankers Association to draw up a Uniform Negotiable Instrument Law. The commission in 1896 proposed a Uniform Act. This Act has since been adopted in all the states.

**Transfer of Negotiable Instruments.** *Negotiation* is the act of transferring a negotiable instrument, such as

ALBANY, NEW YORK, <u>May 28,</u> 19 <u>    </u>	
<b>THE WESTERN BANK &amp; TRUST CO.</b> 13-26	
<small>MEMBER FEDERAL RESERVE SYSTEM</small>	
PAY TO THE ORDER OF <u>C. E. Erast . . . . .</u>	<u>\$100.00</u>
<u>One Hundred and no/100. . . . .</u> DOLLARS	
CLIFTON HEIGHTS BRANCH	 

A Check.

a draft, a check, or a promissory note, to another party in such a manner that the instrument is payable to that party. The simplest way for a person who owns a negotiable instrument to negotiate it is to write his name on the back of the instrument and deliver it to the other party. When a person writes his name on the back of a negotiable instrument before he delivers it to someone else, he is said to *indorse* the instrument. There are several different types of indorsements, all of which are fully discussed in Chapter XXIII.

If a negotiable instrument is payable to the "order" of some specified party, that person must indorse the instrument when he transfers it to someone else. If a negotiable instrument is payable to "bearer" (the person who holds the instrument) rather than to the order of a specified person, the holder may transfer it merely by delivery to another person.

When a negotiable instrument is transferred to one or more parties, these parties may acquire rights that are superior to those of the original owner. Parties who acquire rights superior to those of the original owner are, as is explained in Chapter XXIV, known as *holders in due course*. It is mainly this feature of the transfer of superior rights that gives negotiable contracts a special classification all their own.

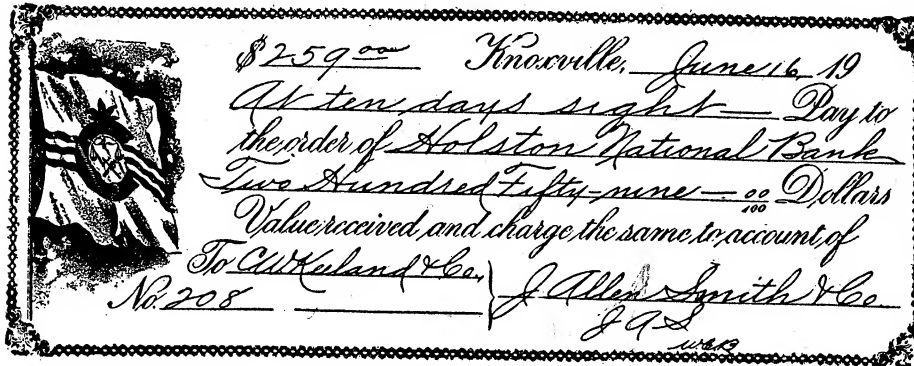
The law has clothed negotiable instruments with special advantages as a means to promote and to encourage commerce. How this is done will be more evident as the subject is developed.

**Classification of Negotiable Instruments.** The basic negotiable instruments may be classified as follows:

- (1) Bills of exchange
- (2) Promissory notes

Inasmuch as these negotiable instruments are discussed in detail in succeeding chapters, a definition of each type will suffice at this time.

**Bills of Exchange.** As defined in the Negotiable Instruments Law, a bill of exchange is "an unconditional order in writing addressed by one person to another, signed by




A Time Draft.

the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer." The three main divisions of bills of exchange are drafts, trade acceptances, and checks.

TRADE ACCEPTANCE	
No. <u>101</u>	<u>Peoria, Illinois, March 4, 1919</u>
To <u>Brown Store Company</u>	<u>Cleveland, Ohio</u>
On <u>June 2, 1919</u>	Pay to the order of <u>Ourselves</u>
<small>(DATE OF MATURITY)</small>	
<u>Five hundred and no/100</u>	<u>Dollars, (\$ 500.00)</u>
The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawee may accept this bill payable at any bank, banker or trust company in the United States which he may designate.	
Accepted at <u>Cleveland</u> on <u>March 7, 1919</u>	
Payable at <u>First Trust Company Bank</u>	By <u>Smith, McCord &amp; Company</u>
<u>Brown Store Company</u>	
By <u>D. C. Brown, Pres.</u>	By <u>A. M. Smith, Treasurer</u>
<small>(SIGNATURE OF ACCEPTOR)</small>	

A Trade Acceptance.

**Promissory Notes.** A promissory note is defined by the Negotiable Instruments Law as "an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer."

\$ 97.45	Allentown, Pa., April 14, 19
Twenty days after date, I promise to pay to	
the order of Lee & Roberts	
	
Ninety-seven and 45/100 Dollars.	
Without defalcation for Value received	
No. 55	Due May 14 R. E. Condon

A Promissory Note.

There are commercial instruments other than bills of exchange and promissory notes which are usually negotiable. National bank notes, United States Treasury notes, and United States silver certificates are special forms of promissory notes which are negotiated by simple delivery. In addition to these, there are bonds and certificates of deposit which are negotiable in form under certain circumstances. Whether or not they are negotiable depends upon their wording.

**Parties to Negotiable Contracts.** All parties to negotiable contracts are designated by certain terms depending upon the particular type of contract. Some of these terms are common to all types of negotiable contracts, while others are restricted to one type only. The same individual may be known by one term at one stage and may be designated by another term at a later stage through which the instrument passes before it is collected. These terms are:

**Payee.** The party to whom any negotiable contract is made payable is called the *payee*.

**Drawer.** The person who executes any bill of exchange, such as a draft, a trade acceptance, or a check, is called the *drawer*.

**Drawee.** The person who is ordered to pay a bill of exchange is called the *drawee*.

*Acceptor.* When the drawee accepts a bill of exchange, that is, indicates his willingness to assume responsibility for its payment, he is called the *acceptor*. In the case of a sight draft or a check, the drawee indicates his *acceptance* by paying the instrument according to its terms. Time drafts are accepted by writing upon the face of the instrument these or similar words: "Accepted this 10th day of June, 1950. John Daws." This indicates that John Daws is willing to perform the contract according to its terms.

*Maker.* The person who executes a promissory note is called the *maker*. He is the one who contracts to pay the amount due on the note. His obligation is similar to that of the acceptor of a time draft.

*Bearer.* Any negotiable contract may be made payable to "bearer." The payee of such an instrument is the bearer. If the payee is "Myself," "Cash," or another similar name, these terms are equivalent to "bearer."

*Holder.* Any person who has possession of a delivered negotiable instrument is called the *holder*. The payee is the original holder.

*Indorser.* Where the payee of a draft, a check, or a note wishes to transfer the instrument to another party, he must indorse it. He is then called the *indorser*.

*Indorsee.* A person who becomes the holder of a negotiable instrument by indorsement is called the *indorsee*. If he obtains possession of a "bearer" instrument, he is merely another holder unless he required the preceding holder to indorse it. This he can do even though the indorsement is not necessary to transfer title.

**Negotiation and Assignment.** In some respects negotiation and assignment are the same; in others they are different. In each case there are primary parties. If a contract is a promissory note, the original or primary parties are the maker (the one who promises to pay)

and the payee (the one to whom the money is to be paid). Between the primary parties, both a nonnegotiable and a negotiable contract are equally enforceable. Also, the same defenses against fulfilling the terms of the contract may be set up. For example, in either case, if one party to the contract is a minor, he may set up his incapacity to contract as a defense against carrying out the agreement.

Although nonnegotiable and negotiable instruments are alike in the rights given to the primary parties, they are different in the rights given to subsequent parties. When a nonnegotiable instrument is transferred by assignment, the assignee receives only the rights of the assignor and no more. (See Chapter IX.) If one of the original parties to the contract has a defense that is valid against the assignor, it is also valid against the assignee. When an instrument is transferred by negotiation, however, the party who receives the instrument in good faith and for value will ordinarily have rights that are superior to the rights of the original holder. The nature of these rights and the conditions under which they are received are discussed in later chapters.

Tate owed Danner \$500 due in ninety days. Soon after this debt was incurred by Tate, he sold Danner a television set for \$300 with the general understanding that a settlement of both claims would be made at the same time. Danner, before the due date, assigned his right to receive \$500 from Tate to Bolton. When Bolton demanded payment from Tate, he claimed the right of offset to the amount of \$300. He was allowed to do this because Bolton received by assignment no better rights than Danner had.

Under the same facts set out above, Tate gave Danner a negotiable note for \$500 due in ninety days. Danner then sold this note to Bolton, an innocent purchaser. In that event, Tate could not offset his contract to receive \$300 against his contract to pay \$500. Since the contract was a negotiable one and Bolton was an innocent purchaser, he, Bolton, obtained rights greater than Danner. This was not possible under assignment.



**QUESTIONS AND PROBLEMS FOR DISCUSSION**

1. Smith borrowed \$500 from Alexander and agreed to repay it in sixty days with six per cent interest. When the sixty days were up Smith tendered Alexander a check for the amount due. The check was payable to Smith and drawn by Lowe.

(a) Was Alexander obligated to accept this check?

(b) If Alexander refused to accept it, would this refusal stop the running of interest?

(c) If Alexander did accept it, would Smith have to indorse it?

2. What do the letters N. I. L. mean?

3. (a) Define a bill of exchange.

(b) Define a promissory note.

4. (a) Makurath gave Sooter a note for \$500 due in ninety days. When the note came due, Makurath refused to pay it, claiming Sooter owed him \$500 for work done. Assuming that Makurath was able to prove that Sooter owed him \$500, did Makurath have to pay the note?

(b) Would your answer be different if Sooter had sold the note before maturity to an innocent purchaser and this innocent purchaser had demanded payment of Makurath?

5. Name the nine different parties to negotiable instruments.

6. May one party be both a holder and a drawer of a bill of exchange?

7. Explain the difference between negotiation and assignment.

8. Are nonnegotiable contracts enforceable?

9. Link gave Thomas a promissory note for \$150 in payment for a refrigerator that was warranted to be new. Thomas transferred the note to Yancy before it was due. When the note was due, Yancy presented it to Link for payment. Link refused to pay it on the ground that the refrigerator he bought was not a new one and that he had therefore been defrauded. If Yancy had taken the note in good faith, for value, and without knowledge of the fraud, would the value of the refrigerator have any bearing on the amount that Link would have to pay Yancy?

10. Who are the parties to a time draft? to a check? to a promissory note?

## CHAPTER XX

### BILLS OF EXCHANGE

*"A thing void in the beginning does not become valid  
by lapse of time."*

FOREWORD. Bills of exchange consist of drafts, trade acceptances, and checks. Each of these is a negotiable contract, but still each class of bills of exchange differs in form and the circumstances under which it arises. All of them were designed to facilitate trade and commerce. In addition to learning the differences in each of these classes, it is also well to visualize the ways in which they tend to facilitate trade.

**What Is a Bill of Exchange?** A *bill of exchange*, commonly called a *bill* or a *draft*, is defined by the Uniform Negotiable Instruments Act as "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer."

A bill of exchange is drawn or executed by a party known as the *drawer* of the bill. It is made payable to a party, known as the *payee*, who has the drawer's authority to collect the amount indicated on the instrument. It is addressed to a party, known as the *drawee*, who is ordered by the drawer to pay the amount of the instrument when the amount is demanded by the payee or some other party to whom the payee has transferred the instrument by indorsement. The drawee, after he has accepted the instrument, that is, has agreed to pay it, is known as the *acceptor*.

If a bill of exchange is payable in the same state in which it is drawn, it is called a *domestic bill of exchange*. If it is drawn in one state and payable either in another state or a foreign country, it is called a *foreign bill of*

*exchange*. This distinction is important if the instrument is dishonored, as will be pointed out in Chapter XXIV.

**Forms of Bills of Exchange.** There are three separate and distinct forms of commercial paper known as bills of exchange. They are very similar, yet each has a separate and clearly recognized form. These forms are:

- (1) Drafts: sight drafts and time drafts
- (2) Trade acceptances
- (3) Checks: individual checks, certified checks, cashier's checks, and bank drafts

## DRAFTS

**Sight and Time Drafts.** A sight draft is a draft payable at sight or upon presentation by the drawee or holder. It indicates that the amount is either due or past due and that the drawer is demanding payment at once.

NO PROTEST TAKE THIS OFF BEFORE PRESENTING	\$ 236 <sup>87</sup> / <sub>100</sub>	St. Louis, Mo., Jan 8 19
	At Sight	Pay to the
	Order of Shirley Bras & Co	
	Two Hundred Thirty-six <sup>87</sup> / <sub>100</sub> Dollars	
	Value received and charge the same to account of	
To J. J. Barron	Southern Mfg Co	
No. 25 Denver, Colo.	G. R. H.	

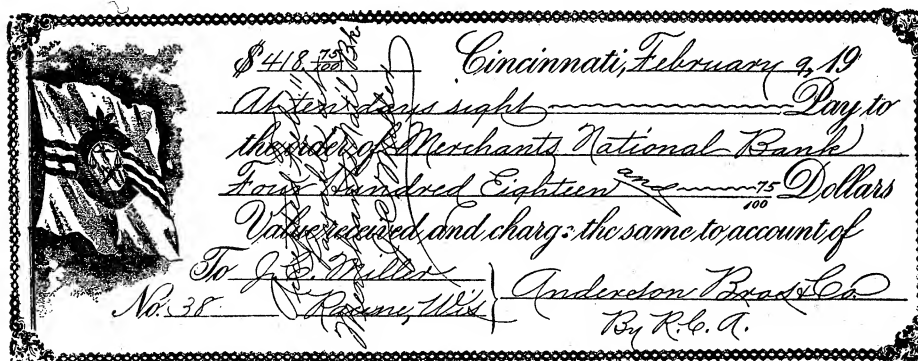
A Sight Draft.

A time draft (see page 195) indicates that the obligation is not yet due or that the drawer is willing to allow additional time in which the drawee may make payment. Time drafts are usually made payable a certain time "after sight" or "after date." In order that the date of maturity of a draft payable a certain time after sight will be fixed, the draft must be presented to the drawee for *acceptance*.

**The Acceptance.** Any bill of exchange is merely an order by one party directed to another ordering him to pay either the drawer or some other payee. In this sense the draft, whether a sight draft or a time draft, is a dignified dun. Like all duns it may be ignored, but not always with impunity. The usual business-like method is to accept it if the amount is owed. If the instrument is a sight draft, the only way to accept it is to pay it when it is presented. If it is a time draft, the acceptance is indicated by writing across the face of the draft any words that indicate an intention to be bound on the instrument. The usual form is as follows:

"Accepted, June 1, 1950, John Doe."

A time draft may be drawn so as to be payable so many days "after sight" or so many days "after date." The time of a draft payable after sight runs from the date of the acceptance. The time of a draft payable after date runs from the date written on the instrument by the drawer. A draft payable after sight should be presented for acceptance promptly because the presentation fixes the due date. A draft payable after date need not be presented for acceptance before it becomes due, but if it is not so presented, there is no way of knowing whether or not the drawee is willing to pay it on the due date. There is little point in drawing a time draft if it is not presented for acceptance.



An Accepted Time Draft.

**Obligation of the Acceptor.** When a draft is presented to a drawee for acceptance, he must either accept or return it. If it is not returned within a reasonable time, it is presumed to have been accepted. After the instrument has been accepted, the drawee is unconditionally and absolutely required to pay the amount of the instrument; he is therefore primarily liable for the obligation.

When the drawee accepts a time draft, he makes the following three admissions concerning the drawer:

- (1) That the signature of the drawer is genuine
- (2) That he owes the drawer the amount shown on the draft
- (3) That the drawer has both the capacity and the authority to draw the draft

The drawee, by accepting a draft, also admits the payee's capacity to indorse, but not the genuineness of the payee's indorsement.

Having made these admissions, the acceptor cannot later deny their accuracy against a holder in due course.

O'Kelly forged Cohen's name as drawer to a draft for \$3,000 payable to O'Kelly. He presented it to Smith for acceptance. O'Kelly then transferred the draft by indorsement to Berger. Later Smith learned that Cohen's signature was forged and refused to pay the draft when it became due. He could not avoid payment because he admitted the genuineness of Cohen's signature when he accepted the draft. It was then too late to raise the defense of forgery against Berger. He could proceed, of course, against O'Kelly.

**Use of Drafts.** Prior to the rise of banks, drafts were used as a substitute for money when making foreign remittances. Now checks are used primarily for this purpose, sight drafts are used as instruments of collection, and time drafts are used to convert accounts receivable past due into notes receivable. At maturity the time draft in turn becomes an instrument of collection.

When drafts are used as instruments of collection, a bank is usually made the payee. When the drawee pays

the draft to the bank, the bank in return remits to the drawer or holder, or else deposits the face of the draft less a small collection charge to the credit of the drawer or holder. Since, as a rule, drafts are only used to collect accounts in other cities than the one in which the drawer is located, the more common practice is for the payee bank to remit to the drawer.

### TRADE ACCEPTANCES

**Trade Acceptance.** The trade acceptance is invariably a time bill of exchange. In legal effect it is identical with the time draft. Its use is confined to the sale of goods. It is defined as "a bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser." It is drawn at the time the goods are sold. The seller is the drawer, and the purchaser is the drawee. Both the trade acceptance and the time draft in accounting are notes receivable when accepted. The chief difference is that the trade acceptance is always given at the time the goods are sold, and the time draft may be given at the end of a credit period.

### CHECKS

**Checks.** A check is a bill of exchange drawn on a bank and payable on demand. A check is very similar to a sight draft in form but is radically different in legal effect. The chief legal differences between a check and a sight draft are:

(1) The death of the drawer of a check automatically revokes the authority of the bank, the drawee, to pay it.

(2) The drawer who draws a sight draft on a drawee with whom he has no funds commits no crime. It is a fraud, and in most states a crime also, to draw a check on a bank in which the drawer has no funds.

(3) If the holder of a check delays presentment for payment beyond a reasonable time, the drawer is released, provided he can prove an injury due to the delay. If the delay causes no injury, he remains liable until the Statute of Limitations has run on the check. Hence, he must keep funds in the bank for an indefinite period of time. Delay in presenting a sight draft can discharge the drawer regardless of injury.

(4) Presentment by the holder of a check for certification, that is, acceptance, discharges the drawer and all indorsers. This is not true of other bills of exchange.

(5) Acceptance (certification) of a check by the bank constitutes a warranty that the drawer has sufficient funds to pay it and that these funds are being earmarked for payment. No such warranty is given by the acceptor of a draft.

**Special Kinds of Checks.** There are five different special types of checks, each one having a distinguishing characteristic:

- (1) Certified checks
- (2) Cashier's checks
- (3) Bank drafts
- (4) Postdated checks
- (5) Bad checks

*Certified Checks.* A certified check is an ordinary check which the bank, the drawee, has accepted by writing across the face of the check the word "certified," or some similar word, and signed by an official of the bank. Either the drawer or the holder may have a check certified. The effect of having it certified is to establish a primary liability on the part of the bank. The bank not only thereby guarantees the genuineness of the drawer's signature, but warrants that the drawer has sufficient funds to cover the check and that these funds will be earmarked in an amount equal to the check.

If the drawer has the check certified before delivering the check to the payee or holder, he merely adds, but



does not substitute, the bank as a co-promisor of payment. The drawer remains fully liable if the bank refuses or is unable to pay it. If the holder, however, has it certified, he substitutes the bank for the drawer as the one liable for its payment. The drawer is released from liability.

Sherman Matney gave Garner a \$10,000 check on a Grundy bank. Garner, not wishing to cash the check and carry the cash while traveling, had it certified. Before Garner arrived at his destination, the bank failed and its assets were insufficient to pay all its depositors. Garner was the loser since he could have received the cash at the time he had the check certified.

Had Matney been the one who had the check certified and mailed it to Garner, the drawer, Matney, would have remained liable, provided Garner was diligent in presenting it for payment.

*Cashier's Checks.* A check that a bank draws on its own funds and that is signed by the cashier or some other responsible official of the bank is called a *cashier's check*. Such a check may be used by a bank in paying its own obligations, or it may be used by anyone else who wishes to send a remittance in some form other than his own check.

*Bank Drafts.* A bank draft is a check drawn by one bank on another bank. It is customary for banks to keep a portion of their funds on deposit with other banks. A bank, then, may draw a check on these funds as freely as any corporation may draw checks. Since a check in effect is a sight draft, there is no reason why the checks drawn by one bank on another should not be called bank drafts. It helps to distinguish them from individuals' checks.

*Postdated Checks.* A check dated July 1, but drawn on June 20, is a postdated check. It is in effect a ten-day sight draft when so drawn. If the payee is willing to accept such a check, and funds are in the bank on July 1

to cover it, the transaction is a legitimate one. If a check is postdated for the purpose of defrauding someone, then the drawer is guilty under the bad check laws discussed below.

*Bad Checks.* A check drawn on a bank in which the drawer has no funds is a bad check. Such act is a crime under the bad check laws in all states. If one gives a bad check in payment of an existing debt, as a rule no serious harm has been done. The debt merely remains unpaid just as if no check had been given. Some states do not make this a crime. If one induces another to part with money or other property, then the drawer commits a fraud. Some states make the act equivalent to larceny. If the drawer can prove that there was no intent to defraud, then no crime has been committed. The burden of proving this is on the drawer.

**Presentment of a Check for Payment.** Checks, unlike other bills of exchange, are given as immediate payment of accounts, not as an instrument of credit. For this reason, they should be presented for payment within a reasonable time after receipt. As a rule a "reasonable time" is interpreted to mean during banking hours of the next business day after it is drawn. If the payee and the bank are in different towns, then the payee should forward it for presentment not later than the next business day after it is drawn. In rural communities these times may be somewhat longer.

**Effects of Delay in Presentment.** When the drawer gives a check, he should have funds in the bank to cover it. As far as the drawer is concerned, the payee could hold the check for months and still present it for payment. If the delay has not injured the drawer in any way, he cannot complain. If the bank should become insolvent, however, the payee's recovery would be limited to the drawer's pro rata share in the assets of the insolvent

bank. This might mean that the payee could recover nothing on the check. The effect of delay is quite different with indorsers. If the holder through indorsement waits an unreasonable length of time to present the check for payment, all indorsers are discharged whether they have suffered a loss or not.

### QUESTIONS AND PROBLEMS FOR DISCUSSION

1. Name the three different types of bills of exchange.
2. What is the difference between a trade acceptance and a time draft?
3. The following draft was sent to Milton V. Gray:

Denver, Colo., June 20, 19—

At sight pay to the order of Rocky Mountain National Bank for collection one thousand dollars (\$1,000), and charge to the account of

To Milton V. Gray  
Billings, Mont.

R. W. Tate & Co.

- (a) Who is the drawer of this draft?
- (b) Who is to pay the draft?
- (c) Must this draft be presented for acceptance?
4. (a) If the draft in the foregoing case read "At ten days' sight," would it require presentment for acceptance? If it were accepted on June 25, when would it be due?
- (b) If this draft read "Ten days after date pay . . .," would an acceptance be necessary? If it were accepted on June 25, when would it be due?
5. Thomas J. Granger executed the following instrument:

Chicago, Ill., April 10, 19—

At sixty days' sight pay to the order of Charles Hudson five hundred dollars (\$500) and charge the same to the account of

To Albert W. Morris  
St. Louis, Mo.

Thomas J. Granger

(a) If, when Hudson presented the draft for acceptance, Morris refused to accept it, what steps should Hudson take to protect himself?

(b) What is the liability of Granger to Hudson or to subsequent holders?

6. Name five differences between a check and a sight draft.

7. Dotson drew a check on the First National Bank for \$375, payable to Adkins. At the time the check was drawn, Dotson had sufficient funds in the bank to cover the check.

(a) If Adkins held the check for four months before presenting it for payment, would this delay justify Dotson's drawing the money out of the bank?

(b) If the bank during the four months became insolvent and a receiver was appointed, was Dotson released from liability?

8. (a) Why would you prefer a certified check to the personal check of a creditor whose solvency you doubted?

(b) How does a bank certify a check?

(c) Who may have a check certified?

9. Ferris drew a check for two hundred dollars, payable to the order of Culver, on the Merchants State Bank. The check was certified at the request of the payee. If the bank later failed to pay the check, was the drawer liable for the amount?

10. What is the difference between a cashier's check and a bank draft?

11. Under what circumstances would you use either a cashier's check or a bank draft in paying a debt?

## CHAPTER XXI

### PROMISSORY NOTES

*"What is mine cannot be taken away without my consent."*

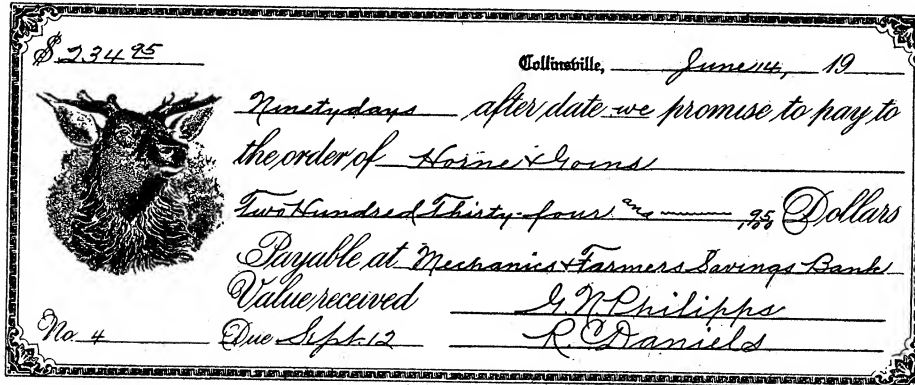
**FOREWORD.** A promissory note contains a promise by the maker to pay, while a bill of exchange contains an order to pay. It is this difference that makes it unnecessary for a promissory note to be accepted. The promisor, the maker, is the one who promises to pay; hence, there is no need to obtain his signature the second time. The form, the use, and the nature of promissory notes differ somewhat from bills of exchange. This chapter deals with those features peculiar to promissory notes alone.

**Definition of a Negotiable Promissory Note.** The Negotiable Instruments Law defines a promissory note as "an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or bearer." This definition is somewhat cumbersome because it must contain every essential element of a negotiable contract. These essentials of negotiability are set out in detail in Chapter XXII.

Any written promise to pay money is a promissory note, but it may not be a negotiable promissory note. It is not necessary to use the word "promise," but the substitute word or words must literally mean "promise." Such expressions as "I will pay" and "I guarantee to pay" have been held to constitute a "promise to pay."

**Parties.** There are two original parties to a promissory note: (1) the one who signs the note and promises to pay, called the *maker*, and (2) the one to whom the promise is made, called the *payee*. If the payee transfers the note, he becomes an indorser and the holder becomes the indorsee.

**Joint and Several Notes.** If a note is signed by two or more makers, it may be a joint note, a several note, or a joint and several note. A *joint note* is one in which two or more persons jointly promise to pay; a *several note* is one in which two or more persons, in the same instrument, separately and distinctly promise to pay; and a *joint and several note* is a combination of the other two. If a note reads, "We promise to pay," it is a joint note. The makers are then collectively liable for its payment. If a note reads, "Either of us promises to pay," it is a several note. The makers are individually liable for its payment. If a note reads, "We jointly and severally promise to pay," it is a joint and several note. Should the instrument read, "We, or either of us, promise to pay," it is also a joint and several note.



A Joint Note.

**Obligation of the Maker.** The maker of a promissory note (1) expressly agrees that he will pay the note when it is due, (2) admits the existence of the payee, and (3) warrants that the payee is competent to transfer the instrument by indorsement. The Negotiable Instruments Law provides that "The maker of a negotiable instrument by making it engages that he will pay it according to its tenor, and admits the existence of the payee and his then capacity to indorse."

Massey made a note payable to Hess or order, and Hess indorsed the instrument to Frazier. Hess was an

infant. When Massey refused to pay the note upon its due date, Frazier brought an action against him. Massey set up the defense that the infant was not competent to indorse the note to Frazier and therefore Frazier could not sue and recover on the note. The court held that Frazier could recover. Massey, by making the note payable to Hess, an infant, asserted the competency of Hess to negotiate and to assign the paper.

**Special Types of Negotiable Notes.** In addition to the general promissory note widely used in business, there are several classes of negotiable contracts which go under various names but which, in legal effect, are negotiable notes. The most common of these are:

- (1) Certificates of deposit
- (2) Bonds
- (3) Interest coupons

Any contract, the terms of which correspond to the definition of a negotiable promissory note, is classed as one under the Negotiable Instruments Law. The content, not the form or the name by which it is generally known, is the test as to whether or not the contract is a negotiable promissory note. As a rule the three special classes mentioned above contain all the essentials of a promissory note.

*Certificate of Deposit.* Many banks still use the certificate of deposit for savings accounts. When the depositor opens an account, a certificate of deposit, similar in form to a promissory note, is issued by the bank to the depositor. The certificate may be made payable on demand or after a definite period of time. As a rule, these certificates of deposit contain all the essentials of negotiability set out in Chapter XXII and are negotiable. Even when they are not negotiable, they may readily be assigned.

If one wishes to withdraw a part of his savings, he must return the certificate of deposit. The bank cancels the certificate and issues a new one for the amount of money redeposited. Because of the awkward nature of



this type of transaction, most banks today issue to the depositor a savings deposit book in which is entered all deposits and all withdrawals.

*Bonds.* Bonds are written contract obligations, generally issued by a corporation, a municipality, or a government, which contain a promise to pay a sum certain in money at a fixed or determinable future time to order or to bearer. They may contain, in addition to the promise to pay, certain other conditions and stipulations. If they are issued by a corporation, they are generally secured by a deed of trust on the property of the corporation.

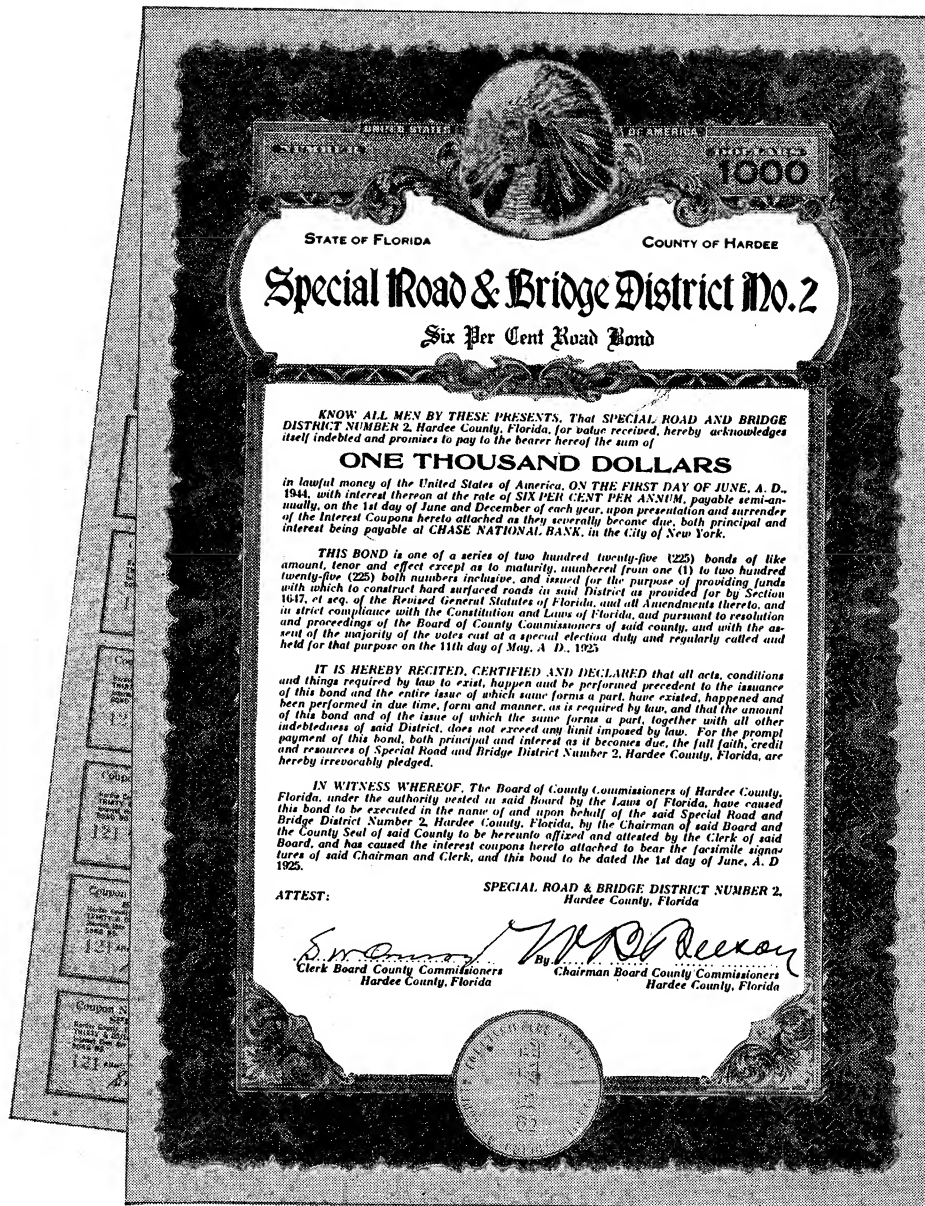
Bonds, which are more formal than ordinary promissory notes, may be classified as follows:

- (1) Registered bonds
- (2) Coupon bonds

A *registered bond* is recorded under the name of the purchaser by the organization issuing it to guard against its loss or destruction. When a registered bond is sold, a record of the transfer to the new holder must be made under the name of that holder.

A *coupon bond* is so called because the interest payments are made by means of small notes or coupons attached to the bond itself. Each coupon matures at the end of a designated interest period and covers the amount of interest due on that date. These coupons are cut off the bond as they mature and are presented at a bank or any other specified institution for payment. They may also be severed before they are due and transferred without the bond itself. Coupon bonds are usually payable to the bearer; as a result, they can be negotiated by delivery.

*Interest Coupons.* Coupon bonds described above have attached to the bond an interest coupon. A ten-year coupon bond with interest payable semi-annually has



A Coupon Bond.

twenty interest coupons attached. At the end of each six months, the holder detaches one interest coupon. This coupon may be negotiated like a check or a negotiable promissory note. The coupon contains a promise to pay to the bearer a definite sum of money on demand, and thus may be classed as a special type of promissory note.

**QUESTIONS AND PROBLEMS FOR DISCUSSION**

1. Name the parties to a promissory note.
2. Is a promissory note that is nonnegotiable collectible?
3. If two parties sign a promissory note as comakers, are they jointly liable or is each one separately liable for the full amount?
4. Ellett, the payee of a promissory note, was an infant. He transferred this note to Jackson, who took it for value and without knowledge of Ellett's infancy. Clancy, the maker of the note, refused to pay the holder on the ground that Ellett had no legal right to transfer it.
  - (a) What warranty of the maker of a note applies in this instance?
  - (b) Was the holder of the note legally entitled to collect?
5. Name three special kinds of promissory notes.
6. Why should the purchaser of a registered bond have the bond registered on the books of the issuing corporation?
7. Do all banks use certificates of deposit for savings accounts?
8. Is the following instrument a promissory note?

Thirty days after date it is agreed that either John Allen or any other holder may demand \$575 from me and I assure you the demand will be granted.

Signed: B. A. Lert

9. Morgan Combs was the holder of a \$5,000 registered bond issued by the Realty Corporation. He failed to notify the Realty Corporation when he bought it from Edward Alvey. Alvey received a semiannual interest check for \$150, all of which had been earned after Combs bought the bond. Alvey cashed the check and kept the money. Combs sued both Edward Alvey and the Realty Corporation jointly for the \$150. Discuss the rights of all parties and give the correct verdict.
10. Is a coupon clipped from a coupon bond a negotiable instrument?

## CHAPTER XXII

### ESSENTIALS OF NEGOTIABILITY

*"The reason of the law is the soul of the law."*

**FOREWORD.** This chapter deals with those features that distinguish a negotiable contract from a nonnegotiable one. There are seven characteristics or essentials of negotiability. These essentials must be learned so that any written contract can be analyzed to see if it meets all seven. If it does, it is negotiable; if it lacks any one, it is nonnegotiable.

**Requirements.** The Negotiable Instruments Law sets forth seven definite requirements as to form with which an instrument must comply in order to be negotiable, that is, transferable. If any one of these requirements is lacking, the contract is not negotiable even though it may be valid and enforceable as between the original parties to the instrument. These seven requirements are:

- (1) The instrument must be in writing and signed by the party executing it.
- (2) The instrument must contain either an order to pay or a promise to pay.
- (3) The order or the promise must be unconditional.
- (4) The instrument must provide for the payment of a sum certain in money.
- (5) The instrument must be payable either on demand or at a fixed or determinable future time.
- (6) The instrument must be payable to the order of a payee or to the bearer of the instrument.
- (7) The payee (unless the instrument is payable to bearer) and the drawee must be designated with reasonable certainty.

**The Instrument Must Be in Writing and Signed by the Party Executing It.** Since a negotiable instrument may circulate freely, it must be written so that as it

passes from hand to hand its contents are not changed. The law does not, however, require that the writing be in any particular form. An instrument may be written with pen and ink or with pencil; it may be typed or printed; or it may be partly printed and partly typed. If an instrument is executed with a lead pencil, it meets the legal requirements of negotiability; but a person might hesitate to accept it because of the ease with which it could be altered without detection.

There is little value to an unsigned form of any kind. On a negotiable instrument, as on other forms, a signature must be placed in order to show the intent of the promisor to be bound. The natural place for a signature is in the lower right-hand corner, but the location of the signature and its form are wholly immaterial if it is clear that a signature was intended. The signature may be written, typed, printed, or stamped. It may be a name, a symbol, a mark, or a trade name. The signature, however, must be on the instrument. It cannot be on a separate paper which is attached to the instrument.

From a legal standpoint, an odd or fictitious signature will bind the maker of a negotiable note as effectively as his real name. Here again, however, the question may later be raised as to whether or not the instrument is "complete and regular on its face" if the signature is peculiarly placed or is of an odd nature. If any feature of the instrument is out of the ordinary, its legal negotiability may be nullified by prudent business customs.

The signature may be signed by another person who has been given authority to perform this act. When an agent signs for his principal or when an officer signs for his corporation, care must be taken not to make himself jointly liable with his principal or corporation. The two signatures below are the correct ones to use to avoid this personal liability when signing for another:

- |                          |                          |
|--------------------------|--------------------------|
| (1) The Acme Corporation | (2) A. B. Jones          |
| By A. B. Jones           | for The Acme Corporation |

The signature should be, but need not be, in the usual place. If one signs a note or other negotiable contract in any way indicating an intention to be bound, it meets the test of the Negotiable Instruments Law. Below are some odd or irregular signatures that are valid:

His

(1) Richard X Cooper

Mark

(2) "I, Thomas Morley," written by Morley in the body of the note, but signed on the typewriter in the usual place for the signature.

(3) "Snowwhite Cleaner," the trade name under which Glendon Sutton operated his business.

**The Instrument Must Contain Either an Order to Pay or a Promise to Pay.** A bill of exchange, such as a draft, a trade acceptance, or a check, must contain an order to pay. A polite request or a suggestion to another to pay will not constitute an order. If the request is imperative and unequivocal, it is an order even though the word "order" is not used.

A promissory note must contain a *promise* to pay. The word "promise" need not be used—any equivalent words will answer the purpose—but the language used must show that a promise is intended. Thus the words "This is to certify that we are bound to pay" were held to be sufficient to constitute a promise.

**The Order or the Promise Must Be Unconditional.** It is a well-established rule that the order or the promise must be absolute and unconditional. Neither must be contingent upon any other act or event. If Baron promises to pay Noffke \$500 "in sixty days, or sooner if I sell my farm," the contract is negotiable because the promise itself is unconditional. In any event he promises to pay the \$500 in sixty days. The contingency pertains only to the time of payment, and that time cannot exceed

sixty days. If the words "or sooner" were omitted, the promise would be conditional and the note would be non-negotiable. It is well to emphasize here again, however, that the contract is valid even though it is nonnegotiable.

**The Instrument Must Provide for the Payment of a Sum Certain in Money.** The contract must call for the payment of money and money alone. It need not be American money, but it must be some national medium of exchange. It cannot be in scrip, gold, bullion, bonds, or similar assets. Frequently, the contract provides for the payment of either money or goods. If the option lies with the holder, such a provision does not destroy its negotiability. If the option to pay in goods lies with the drawer or the maker, the contract is not negotiable, although it is a perfectly valid contract and may be enforced unless there is some valid defense to it.

Sixty days after date I promise to pay to the order of Ira Rasmussen \$500 or 250 bushels of wheat at his option.

Signed—Frank Birchmore.

This note is negotiable because it is at the option of the payee, Rasmussen. If the words "his option" were changed to read, "my option," the note would not be negotiable.

The sum payable must be a certain amount that is not dependent upon other funds or upon future profits.

In consideration for recommending Varney for a certain job, Fulton received the following instrument: "... we hereby agree to pay you the sum of \$1,059 ninety days from date; the amount to be paid out of our profits on the 3 East 40th Street job." The court held that the statement on the note that the money was to be paid out of a particular fund destroyed its negotiability.

Not only must the contract be payable in money to be negotiable, but the amount must be certain from the wording of the instrument itself. A provision in a note for \$5,000 states in addition to the \$5,000 all taxes that



may be levied upon a certain piece of real estate will be paid. This destroys its negotiability. The amount to be paid cannot be determined from the note itself. A provision providing for the payment of interest or exchange charges does not destroy negotiability. Other terms which have been held not to destroy negotiability are provisions for: cost of collection, a 10 per cent attorney's fee, if placed in the hands of an attorney for collection, and installment payments.

Frequently, through error, a negotiable contract calls for the payment of one sum in the figures and a different amount in writing. The amount in writing prevails because one is less likely to be in error in this amount. Also, if anyone should attempt to raise the amount, it would be much simpler to alter the figures than it would be the writing.

Salt Lake City, Utah, <u>March 2, 19</u> No. <u>63</u>	
THE <b>First National Bank</b> <small>OF SALT LAKE CITY</small> $\frac{31-1}{12}$	
PAY TO THE ORDER OF	<u>Carl M. Stanley</u> \$ <u>15<sup>00</sup></u>
<u>Ten and <sup>00</sup>/<sub>100</sub></u> DOLLARS	
<u>H. R. Lester</u>	

**A Check on Which the Amount Differs.**

The bank would pay the holder of this check only \$10 because the amount written in words prevails over the amount expressed in figures.

**The Instrument Must Be Payable Either on Demand or at a Fixed or Determinable Future Time.** An instrument meets the test of negotiability as to time if it is payable on demand as in a demand note, or at sight as in a sight draft, or when no time is specified as in a check. In any one of these cases the instrument becomes past due after a reasonable length of time.

If the instrument provides for payment at some future time, the due date must either be fixed or so definitely stated that the due date can be determined. The date must be sure to arrive.

Vaughn gave Marx an instrument containing the following provision: "I promise to pay Marx the sum of \$450 when my son reaches the age of twenty-one." Such a condition rendered the instrument nonnegotiable because the time of payment was dependent upon a condition that might not happen. In other words, Vaughn's son might never reach the age of twenty-one.

If Riggs promises to pay Burton \$500 "sixty days after my marriage," the instrument is not payable at a determinable future time because the event is not certain to occur. If the words "after my death" were used instead of "after my marriage," the time would be determinable because the event is bound to occur.

Regardless of the wording used, if a due date is absolutely certain to arrive, it meets the test of the law. If the event is bound to occur but is such that it may not occur within a reasonable time, it is legally but not practically negotiable because no prudent person would want to accept it under normal conditions.

**The Instrument Must Be Payable to the Order of a Payee or to the Bearer of the Instrument.** The two most common words of negotiability are "*order*" and "*bearer*." The contract is payable to "*order*" when some person is made the payee and the maker or drawer wishes to indicate that the contract will be paid to the person designated or to anyone else to whom he may transfer the instrument by indorsement.

It is not necessary to use the word "*order*," but it is strongly recommended because everyone puts the same interpretation on this word. A note payable to "Smith and assigns" was held to be nonnegotiable. If it had been payable to "Smith or assigns," it would be negotiable. Also "pay to the order of the holder" would be negotiable, but some people might hesitate to accept a check or other bill of exchange containing such wording.

The law looks to the intention of the maker or the acceptor. If the words used clearly show an intention to pay either the named payee or anyone else whom he designates, the contract is negotiable.

"Bearer," the other word of negotiability, indicates that the maker or the acceptor of a bill of exchange is willing to pay whoever has possession of the instrument at maturity. The usual form in which this word appears is this: "Pay to bearer" or "Pay to Lydia Lester or bearer." There are other types of wordings that render a contract a bearer instrument. For example, if the payee is a fictitious person, it is a bearer instrument even though it contains the word "order." For example, "pay to the order of Payroll," is a bearer instrument. The same is true if it is payable to "cash," "holder," or a name that is clearly fictitious and the fact is known to the drawer.

The reason a clear distinction must be made between "order" negotiable contracts and "bearer" contracts is that title to the latter may be obtained by delivery only, while title to "order" instruments can be obtained only by indorsement and delivery.

**The Payee and the Drawee Must be Designated with Reasonable Certainty.** When a negotiable instrument is payable "to order," the payee as in the case of a promissory note and the drawee in the case of a bill of exchange must be named so that the specific party can be identified with reasonable certainty. For example, a check which reads, "Pay to the order of the Treasurer of the Virginia Education Association" is not payable to a specific party, but that party can be ascertained with reasonable certainty and the check is negotiable.

**Execution and Delivery.** The Negotiable Instruments Law defines delivery as: "Every contract or a negotiable contract is incomplete and revocable until the delivery of the instrument for the purpose of giving effect there-

to." Without this delivery there can be no force or effect to the contract. To constitute delivery the maker or drawer must give over control of the instrument to the holder for the sole purpose of giving effect to it, that is, making a binding obligation according to its terms. There can be a delivery without its being absolute, that is, without the delivery giving effect to the contract. If the delivery is made with the understanding, oral or written, that the instrument is not to become effective until some condition is met, then this condition must be met before any liability arises under the contract. All of this is true, of course, only between the primary parties.

When a fully completed negotiable contract is in the hands of a holder in due course (see Chapter XXIV for a discussion of holders in due course), a valid delivery not only is presumed, but it is *conclusively* presumed. The chief purpose of the Negotiable Instruments Law is to protect innocent purchasers against irregularities in the past history of the contract.

Cross completely filled out a negotiable note for \$10,000 payable to Schoenborn. Cross left the note lying on his desk intending to deliver it the next day if certain conditions were met. Schoenborn saw the note, picked it up, and sold it to Morley, an innocent purchaser. Cross cannot plead nondelivery against Morley. Had Schoenborn attempted to collect the note from Cross, nondelivery would have been a complete defense.

**Delivery of an Incomplete Instrument.** If a negotiable contract is only partially filled out and signed before delivery, the maker or drawer is liable if the blanks are filled in according to instructions. If the holder fills in the blanks contrary to the authority given him, the maker or drawer is liable to the original payee only for the amount authorized. He is liable to a holder in due course for the amount indicated on the contract. This is on the doctrine that one who has lawful possession of an incomplete negotiable contract has the *apparent* authority to complete the contract for any amount within reason.

If the incomplete instrument is not delivered so that the original holder is not in lawful possession of it, then neither the maker nor the drawer is liable. Nondelivery can be used as a defense even against a holder in due course.

A few states have held that the maker may be estopped to deny liability if his negligence materially aided the payee in perpetrating a fraud resulting in an innocent purchaser being injured thereby.

Larsen filled in a blank note and signed it, leaving the amount and the time blank. This note was stolen, due to no negligence on Larsen's part, by Radel who filled in the amount for \$5,000 and the time for thirty days. This note was then negotiated to Shedd, an innocent purchaser. When Shedd demanded payment of Larsen, payment was refused because of the non-delivery of an incomplete instrument. This was a valid defense.

**Consideration.** All negotiable instruments are contracts, and as such must be supported by a valid consideration like all other contracts. In the hands of an innocent purchaser, consideration is *conclusively* presumed. It is not necessary to recite in the contract that there is a consideration to support it. Frequently, such a recital is made and this often destroys the negotiability of the contract; other times it does not. All negotiable contracts must contain an unconditional promise to pay.

A reference to the consideration in a note that does not condition the promise does not destroy negotiability. The clause, "This note is given in consideration of a typewriter purchased today," does not condition the maker's promise to pay. If the clause reads, "This note is given in consideration for a typewriter guaranteed for ninety days, breach of warranty to constitute cancellation of the note," the contract would not be negotiable. The promise to pay is not *absolute*, but *conditional*. Also, if the recital of the consideration is in such form as to make the instrument a part of another contract, the negotiability of the contract is destroyed.

Mott inserted this statement in a note: "This note is a part of an agreement dated January 19, 1921." The court held that tying up the contract, which constituted the consideration for the note, with the note so that it all constituted one contract destroyed the negotiability of the note.

**Nonessentials of Negotiability.** Since the purpose of the Negotiable Instruments Law is to encourage the transfer of negotiable instruments freely from hand to hand, no minor detail is permitted to destroy an instrument's negotiability. Some of the details which have been held to be nonessential are:

(1) *The instrument need not be dated.* The omission of a date may cause considerable inconvenience, but the date is not essential. The holder may fill in a date if the space for the date is left blank. If an instrument is due thirty days after date, and the date is omitted, the instrument is payable thirty days after it was issued or delivered. In case of dispute the date of issue may be proved.

(2) *The name of the place where the instrument was drawn or where it is payable is not specified.* For contracts in general, one's rights are governed by the law where the contract is made, or where it is to be performed. This rule makes it advisable for a negotiable contract to stipulate the place where it is drawn and where it is payable, but neither is essential for its negotiability.

(3) *The instrument does not show that it was given for "value received."* These words or words of similar meaning were formerly required, but they are no longer essential. The continuation of the practice of using these words is due primarily to the force of habit.

**QUESTIONS AND PROBLEMS FOR DISCUSSION**

1. What are the essential requirements of a negotiable instrument?
2. Would an instrument be within the requirements of the Negotiable Instruments Law if it were entirely printed? Why?
3. Is the following instrument negotiable?

Sixty days after my death I bind my heirs to pay to the Treasurer of the Y.M.C.A., or to anyone else whom he may designate, the sum of \$5,000 with interest from the date of my death.

Signed: Albert Sloan

4. Benjamin Waddell, as an accountant for the Bell Brothers Furniture Company, Incorporated, borrowed money from the bank for the corporation and signed the note as follows on the typewriter:

Bell Brothers Furniture Company, Inc.  
Benjamin Waddell, Accountant

The corporation became insolvent and the bank sued Waddell for the note. Was he personally liable?

5. If an instrument contains an alternative promise at the option of the holder, does this destroy the instrument's negotiability?
6. May an instrument be collectible even though it is not negotiable?
7. Is the following instrument negotiable?

To James Madison:

Pay to the order of myself on January 3, 19—, \$100,  
and also deliver to my order 100 bushels of wheat.

Henry Clay

Accepted December 1, 19—  
At Richmond, Virginia  
James Madison

8. The following instrument was delivered to Alexander Botts:

Chicago, Ill., May 6, 19—

One year after date, The Harpster Manufacturing Company will pay to Alexander Botts, on order, five hundred dollars, or, at his option, will issue to him five shares of the common stock of this corporation.

The Harpster Manufacturing Company  
By G. E. Harpster, Mgr.

- (a) Is this instrument negotiable? Why?
- (b) Is the expression "will pay" equivalent to "promise to pay"?
- (c) If this instrument contained the words "at its option" instead of "at his option," would the instrument be negotiable? Why?

9. A promissory note was made payable three months after the maker's marriage. Another provided for payment three months after the maker became of age. A third was made payable six months after the maker's death. Which of these instruments was negotiable? Explain.

10. Alphonse Burbank signed a blank note and gave it to Z. E. Caruso in payment of a painting with this instruction:

"You fill the note in for any amount you feel reasonable but do not exceed \$10,000, and I will pay it in thirty days."

Caruso filled the note in for \$50,000.

- (a) Was Burbank liable for this amount?
- (b) Would your answer be different if Caruso had sold the note to an innocent purchaser?

11. Is it necessary for a note which reads "Thirty days after date" to be dated?



## CHAPTER XXIII

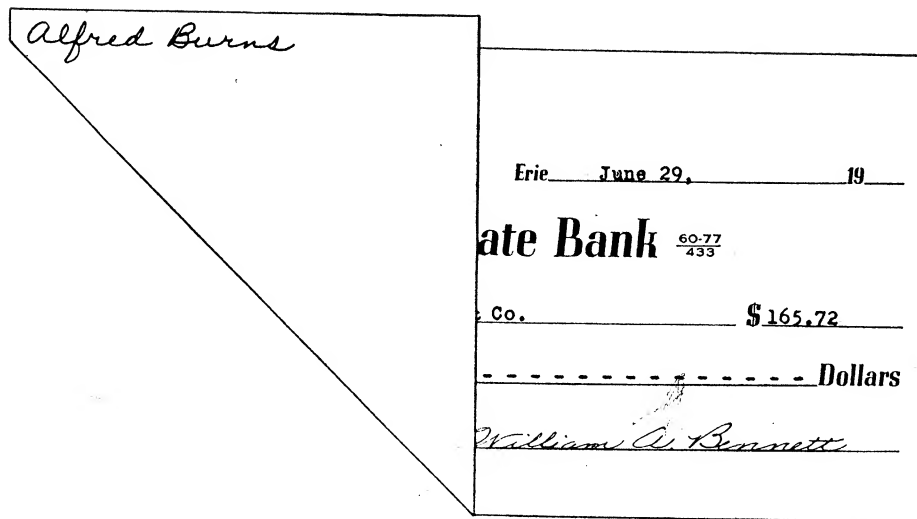
### NEGOTIATION

*"He who uses his legal rights harms no one."*

**FOREWORD.** Whenever one writes his name on the back of a check or note, he assumes some very broad liabilities. Ignorance as to what these liabilities are has caused untold grief and financial loss. This chapter deals exclusively with the various types of indorsements and the warranties made by the indorser in each case.

**Negotiation Defined.** Negotiation is the transferring of a negotiable contract in such a way as to constitute the transferee the holder of the instrument. The negotiation is usually, but not always, for the purpose of transferring title to the holder. As previously noted, some negotiable contracts are made payable to "bearer" and others are made payable to "order." Bearer instruments may be negotiated by delivery without any indorsement. This effectively invests ownership in the holder. In practice an indorsement is usually required even for bearer paper, although this adds nothing to the legality of the negotiation. It merely preserves a written chronological record of all negotiations. If the instrument is payable to "order," there can be a negotiation only by indorsement and delivery. The indorsement is the contract between the indorser and the indorsee or holder. The nature of the contract is fixed by the type of the indorsement as will be indicated later.

**Place of Indorsement.** The usual place to indorse a negotiable contract is on the back of the instrument. If the indorser's signature appears elsewhere and it cannot be determined in what capacity he signed, he will be considered an indorser. In any event, the indorsement must be physically attached to the contract. One may not wish to assume the liabilities of an indorser even



An Indorsed Check Folded to Show the Position of the Indorsement.

though the contract is negotiable. In that event he can assign it by writing out the assignment on a separate piece of paper.

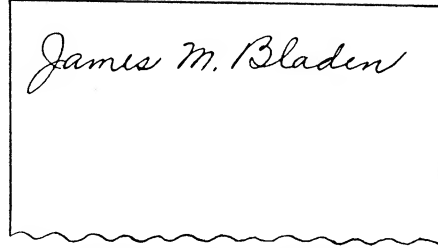
The signature of the indorser may be written in ink or pencil, typed, or made with a rubber stamp, provided the person whose signature is stamped authorizes it. If the maker or drawer misspells the name of the payee, the payee should first indorse exactly as the name appears on the instrument and then immediately following this should write his name correctly. This is not forgery because there is no such individual as the incorrect name. In addition, the author of the correct signature guarantees the genuineness of the preceding signature.

**Kinds of Indorsements.** The Negotiable Instruments Law lists five types of indorsements:

- (1) Blank indorsement
- (2) Special indorsement
- (3) Qualified indorsement
- (4) Restrictive indorsement
- (5) Conditional indorsement

The form of each of these indorsements is as follows:

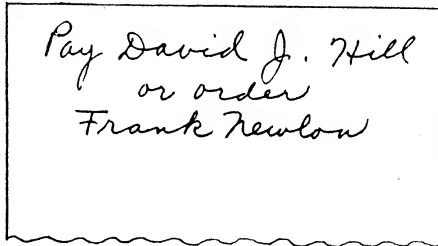
*Blank Indorsement.* The most usual type of indorsement is a blank indorsement which consists of the name only. If the instrument is payable "to order," a blank indorsement converts it into bearer paper.



Indorsement in Blank.

As has been indicated, title to bearer paper may be obtained by delivery only. Thus, the finder of a lost bearer instrument or a thief may collect from the maker if the maker is unaware of the defective title of the finder or thief, and the maker will be protected from any claims of the real owner. The real owner would have a claim against the finder or thief. If the finder or thief negotiates the paper by delivering it to an innocent purchaser, the innocent purchaser would have full title and would hold the proceeds of the paper when collected free of any claim of the former owner. To avoid the risk, therefore, of losing title to an instrument by its being lost or stolen and thereafter sold to an innocent purchaser, the holder of an instrument converted to bearer paper by a blank indorsement may reconvert it to order paper so that it cannot be negotiated merely by delivery. He may do this by indorsing it to himself, using the special indorsement, or by converting the blank indorsement into a special indorsement by writing in over the blank indorsement a direction that payment be made to himself. If he negotiated it further he would have to indorse it a second time.

*Special Indorsement.* A special indorsement designates the particular person to whom payment is to be made. If the paper is bearer paper because of conversion by blank indorsement, a special indorsement reconverts it into order paper. The holder must indorse it before he can further negotiate it. He may, of course, indorse the instrument in blank, which restores it to bearer paper. Each holder has the power to elect either a blank or a



Pay David J. Hill  
or order  
Frank Newlon

**Special Indorsement.**

special indorsement. If the paper is bearer paper at the time of issuance either because it is stated to be payable to "bearer" or because the payee is fictitious, it stays bearer paper and can never be converted into

an order instrument by means of a special indorsement.

*Qualified Indorsement.* As the name indicates, a qualified indorsement has the effect of qualifying, that is, limiting the liability of the indorser. For example, if an agent receives checks in payment of his principal's claims which are made payable to the agent personally, the agent should and can elect to use a qualified indorsement. This is done merely by adding to either a blank or special type of indorsement the words "without recourse" immediately before the signature. This releases the indorser from liability for payment if the instrument is not paid because of insolvency or mere refusal to pay. The indorser still warrants that the instrument is genuine, that he has good title to it, that all prior parties had capacity to contract, and that the instrument to his knowledge is valid. If the agent wishes to avoid even these liabilities, then his only recourse is to return the check to the drawer and have a new one made out to the rightful owner.

Fred Miller is a salesman for the Richmond Wholesale Grocery Corporation. In this capacity he receives a check from a customer of his principal made payable "to the order of Fred Miller." The Richmond Wholesale Grocery Corporation refuses to accept the check unless Fred Miller indorses it either in blank or by special indorsement. To avoid liability Miller should either indorse it "without recourse," regardless of the wishes of his employer, or else should obtain a new check from the customer, payable to the corporation, and return the old one.

*Restrictive Indorsement.* As the term implies, a restrictive indorsement limits or restricts any further

indorsement. The most usual restrictive indorsement is to transfer possession for the purpose of collection. The chief characteristic of such an indorsement is that it transfers possession to the

holder but not title. The indorser confers the powers of a special agent upon the indorsee or holder, and he must account for any proceeds collected.

Restrictive indorsements are widely used when banks become collecting agencies for negotiable paper. If the bank, the agent, should fail before remitting the proceeds to its principal, the indorser, the proceeds would not become a part of the general assets of the bank. These proceeds do not belong to the bank since it is only the custodian of another's funds.

An indorsement that reads, "Pay to Will Shafer only," is also a restrictive indorsement. Such an indorsement transfers title, but further negotiation is prohibited.

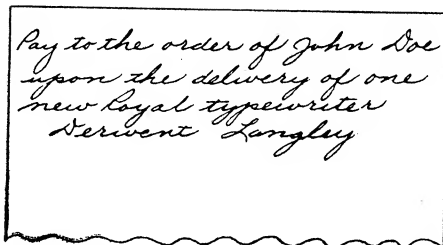
*Conditional Indorsement.* The indorser by special indorsement may wish to impose a condition precedent to the payment. In this event the indorsee may not receive payment until the condition is met. The condition, of course, is binding only between the indorser and subsequent purchasers. The maker, drawer, or acceptor of a draft may disregard the condition and pay the holder. Should the instrument be dishonored by nonpayment, the holder must look to the indorsers. In this event, the condition must be met before collection from the indorsers is possible. If the party primarily liable does pay the

Pay to Rodman Harris  
without recourse  
David J. Hill

Qualified Indorsement.

Pay Merchants Nat. Bank  
Lincoln, Neb.  
For collection  
William G. Wheeler

Restrictive Indorsement.



Pay to the order of John Doe  
upon the delivery of one  
new Royal typewriter  
Derwent Langley

**Conditional Indorsement.**

since the indorser cannot impose an additional obligation upon the one primarily liable.

holder before the condition is met, the holder must hold the money in trust for the indorser who imposed the condition until the condition is met. The maker or the acceptor cannot be sued for wrongful payment

**Obligations of a General Indorser.** A general indorser, that is, a person who transfers a negotiable instrument by an indorsement without qualifications, agrees to make payment in case the instrument is not paid at maturity, provided (1) the instrument is properly presented and (2) due notice of dishonor is given to him.

Every indorser who indorses without qualification makes the following warranties:

(1) *That the instrument is genuine and in all respects what it purports to be.* The holder of a note that has been altered or forged has a right of action against the indorser on his implied warranty that the instrument is genuine.

(2) *That he has a good title to the instrument.* A note was made payable to Underwood or his order. A person of the same name stole the note from Underwood and forged the signature of the payee. The thief transferred the note to Black, who, without knowledge of the forgery, transferred it to Kean, a holder in due course. Kean was entitled to recover from Black.

(3) *That all prior parties had capacity to contract.* If the maker, drawer, acceptor, or any prior indorser is an infant, an insane person, or any person who is incompetent to bind himself by his signature, the holder may recover against his indorser on the latter's implied warranty of the competency of the parties to the contract.

(4) *That, at the time the indorsement is made, the instrument is valid.* An indorser is liable on his implied warranty if the note was given in violation of a statute. Thus a note given in payment of a gambling debt in a state in which such a note is declared void would be unenforceable against the maker in the hands of a holder in due course, but enforceable against the indorser on his warranty of validity.

**Obligation of Negotiator of Bearer Paper.** Bearer paper need not be indorsed when negotiated. Mere delivery passes title. One who negotiates a bearer instrument by delivery alone does not guarantee payment, but he is liable to his immediate purchaser only as a warrantor of the genuineness of the instrument, of his title to it, of the capacity of prior parties, and of its validity so far as he knows. These warranties are the same as those made by a qualified indorser, except that the warranties of the qualified indorser extend to all subsequent holders, not just to the immediate purchaser. But since negotiable instruments are not legal tender, no one is under any obligation to accept bearer paper without an indorsement. By requiring an indorsement even though not necessary to pass title, the holder protects himself by requiring the one who wishes to negotiate it to assume all the obligations of an indorser by indorsement.

Dawson executed a negotiable note payable to bearer and delivered it to Adams, the payee. Adams transferred the note to Rainwater without indorsement. Rainwater by a blank indorsement transferred the note to Hurley. When Hurley presented it for payment, Dawson had become insolvent and was unable to pay. Hurley could sue Rainwater for indemnity, but he could not sue Adams; nor could Rainwater seek reimbursement from Adams.

**Discharge of the Obligation.** Negotiable instruments may be discharged by payment, by cancellation, or by alteration. Payment at or after the date of the maturity of the instrument by the party who is primarily liable

constitutes proper payment. Cancellation consists of any act that indicates the intention to cancel the instrument. A cancellation is not effective, however, when it is made unintentionally or by mistake. The maker or the drawer of an instrument is discharged from liability if the instrument is materially altered without his consent. If such an instrument gets into the hands of a holder in due course, however, the holder in due course may collect from the maker or drawer according to the original terms of the instrument, and not according to its altered terms.

Shea made a note payable to the order of Snow, who indorsed it to McCormick. The amount of the note was altered from fifty dollars to five hundred dollars. McCormick negotiated the instrument to Phillips, who was unaware of the alteration. The court held that Phillips could enforce payment from Shea to the amount of fifty dollars. Phillips could also recover damages from McCormick.

The obligations of the parties may be discharged in other ways, just as in the case of a simple contract. For example, the parties will be discharged from liability if they have been judicially declared bankrupt or if there has been the necessary lapse of time provided by a statute of limitations.

Frequently a negotiable instrument is lost or accidentally destroyed. This does not discharge the obligation. The party obligated to pay it has a right to demand the instrument's return if this is possible. If this cannot be done, then he has a right to demand security from the holder adequate to protect the payer from having to pay the instrument a second time. The security usually takes the form of an indemnity bond.



**QUESTIONS AND PROBLEMS FOR DISCUSSION**

1. Define negotiation.
2. Where should an indorsement normally appear on a contract?
3. May an indorsement be typewritten?
4. Alex Smith drew a check payable to Humman Arnall and delivered it to Herman Arnall. Herman indorsed the check as follows:

Humman Arnall  
by Herman Arnall

Was this the correct way to indorse a check when the payee's name was misspelled?

5. Roberts, the holder of a draft, indorsed the draft in blank and transferred it to Merola. Merola later wrote over the blank indorsement these words:

Indorser waives notice of protest.

Was this addition valid?

6. An indorsement reads: "Pay to James Coram only." What is the legal effect of this indorsement?

7. What is the advantage of a special indorsement over a blank indorsement?

8. Bell wished to borrow \$5,000 from the bank. Before the bank would loan the money, it required Bell to get H. C. Cofer, a prominent businessman, to indorse the note as added security. When the note was made out, it read: "Ninety days after date, I promise to pay to the order of H. C. Cofer, \$5,000."

Signed: Dan R. Bell

H. C. Cofer then indorsed the note in blank to the bank. Was this the proper method of drawing and indorsing this note?

9. What is the significance of the words in an indorsement: "for collection only"?

10. Richards prepared the following note:

Ninety days after date I promise to pay to the order of Gene Vaughn \$1,000 with 6% interest from date.

Signed: E. J. Richards

Richards lost this note before delivering it to Vaughn and Vaughn found it. Richards, before he lost it, had decided not to give the note to Vaughn. Was he liable on the note?

## CHAPTER XXIV

### HOLDERS IN DUE COURSE

*"Things invalid from the beginning cannot be made valid by a subsequent act."*

**FOREWORD.** A holder in due course has certain rights which are often superior to those of the original holder. For one to be classed as a holder in due course, he must meet certain specific tests. In this chapter we will learn under what conditions a holder can come under this classification. When there are indorsers on a negotiable instrument, the holder must, whether he is a holder in due course or not, take certain specific steps to collect from the maker or acceptor and to inform the indorsers in the event the instrument is dishonored. When the instrument comes due, the holder can look to the maker and all indorsers for payment. Through negligence he can forfeit some of his rights.

**Holders in Due Course.** Negotiable instruments would have no advantage over ordinary contracts if the remote parties could not be given immunity against many of the defenses which might be made against informal contracts. To enjoy this immunity, the holder of a negotiable instrument must be a holder in due course. The term *innocent purchaser* is another term used to describe a person who is a holder in due course. Neither term can be used to describe any one but the holder of a negotiable instrument who has obtained it under these conditions:

- (1) The instrument must be complete and regular on its face.
- (2) It must not be past due at the time of the negotiation.
- (3) The holder must take the instrument in good faith and for value.
- (4) At the time the instrument is negotiated, the holder must have no notice of any infirmity in the instrument or any defect in the title of the person who negotiated it.

*The instrument must be complete and regular on its face.* Checks, notes, and drafts, the most common types of commercial paper, are usually printed with blank spaces which are to be filled in by the person executing them. The instruments are regular when these spaces have been filled in properly and the instrument is signed. Any material deviation from this regular practice makes the instrument irregular, and the holder takes it subject to all the defenses which the maker or acceptor can make against the original holder. If he has no defenses, the irregularity does not necessarily render the contract unenforceable.

Blank notes generally have a space for the rate of interest. If a note is non-interest-bearing, this space should be crossed out with x's. If this is done, and then "8%" is later written over the "x's," the note is not regular and the holder cannot be considered innocent. He is charged with notice that this may have been done subsequent to the delivery. If it later develops that the maker wrote the "8%" before delivering it, the contract is enforceable if there are no other defenses. The holder, however, cannot enjoy the privileges of an innocent purchaser. The irregularity is a warning signal to a prospective purchaser. If he does not heed the warning, he cannot claim immunity to any defenses.

*The instrument must not be past due.* One who takes an instrument that is past due cannot be an innocent purchaser. If it is due and unpaid, there must be a reason. It is the duty of the prospective purchaser to ascertain that reason. If he fails or neglects to do so, he forfeits the privileges of a holder in due course. If the note is dated and payable in a fixed number of days or months, the instrument itself indicates whether or not it is past due.

If the instrument is transferred on the date of maturity, it is not past due but would be overdue on the day following the due date. If it is payable on demand, it is due within a reasonable time after it is issued. What is

a reasonable time “depends upon the nature of the instrument, the usage of trade or business with respect to such instruments, and the facts of the particular case.” For example, if a demand note is given in temporary settlement for merchandise purchased for which the usual terms are 2/10, n/60, a reasonable time would be approximately sixty days.

*The holder must take the instrument in good faith and for value.* In order to be a holder in due course, the purchaser of a negotiable instrument must give value for the instrument in good faith and without knowledge of dishonor. When a person buys an apparently good negotiable instrument for an unreasonably small sum and makes no inquiry as to the reason for the small amount, he will not be considered a holder in due course because there is evidence of bad faith on his part.

Tate held a note for \$5,000 signed by Storey. Before maturity he sold the note to Aderhold for \$3,000 cash and an old spinning wheel that formerly had been in the Tate family. When Aderhold attempted to collect from Storey he refused to pay, claiming that there was no consideration since the note represented a gift.

Lack of consideration is not a good defense against a holder in due course. Buying a \$5,000 note at a \$2,000 discount would be sufficient notice to warn Aderhold that the note was not genuine. In this case, however, Tate placed a value of \$2,000 on the old spinning wheel because of a sentimental attachment. For this reason, there was no circumstance to warn Aderhold that something was lacking in the genuineness of the obligation. Storey would have to pay Aderhold since he was a holder in due course.

If a man takes a note at a discount at the rate of 10 per cent a year, he has paid value even though the legal rate of interest is only 8 per cent. If the rate of discount is too high, it will be construed as evidence of bad faith and the holder will not be considered an innocent purchaser.

*At the time the instrument is negotiated, the holder must have no notice of any infirmity in the instrument or*

*any defect in the title of the person who negotiates it.* The holder need not have actual knowledge of facts that make the instrument defective. He is considered to have notice of such facts if he has received from any source any information that would make a reasonably prudent man investigate the instrument before accepting it. The title of a person who negotiates an instrument is defective when he obtains it by fraud, duress, or other unlawful means; or for an illegal consideration; or when he negotiates it in breach of faith or under circumstances amounting to fraud.

Bell sold a secondhand truck to Sellers for \$1,000 and guaranteed it to be in first-class condition. Bell had stolen the truck. The truck was in extremely poor condition, a fact which Bell knew. About a week after Sellers bought it, he sold it to Bodine for \$1,500 and took a ninety-day negotiable note in payment. Sellers then offered to discount the note to Bell at 8 per cent. Bell accepted the offer. About two weeks later, the real owner of the truck repossessed it from Bodine. When the note came due, Bodine refused to pay it. At the time Bell took the note he knew it had been given in payment of the truck sold to Sellers; therefore, he was not a holder in due course. He had knowledge of the infirmity.

The first holder in due course brings into operation for the first time all the protections which the law has placed around negotiable contracts. When these protections once accrue, they are not easily lost. Consequently, a subsequent holder may avail himself of them even though he himself is not a holder in due course. For example, Adams, without consideration, gives Bryce a negotiable note due in sixty days. Before maturity Bryce indorses it to Cordell under conditions which make Cordell a holder in due course. Ten days after maturity Cordell sells the note to Gray, but Gray is not a holder in due course since he did not obtain the note before maturity. If Gray is not a party to any wrongdoing or illegality affecting this instrument, he acquires all the rights of a holder in due course. This is true because Cordell had

these rights, and when Cordell sold the note to Gray, he sold all of his rights, which include the right to collect the amount due and the right to be free from the defense of no consideration.

Loureinski executed a ninety-day negotiable note for \$1,000 in favor of Karker. Before maturity Loureinski sold Karker \$800 worth of lumber and intended to apply it as a credit on the note when it became due. Before maturity Karker sold the note to Littlepaige, a holder in due course. Littlepaige in turn indorsed the note over to Kaminsky in settlement of a debt that he owed Kaminsky. Kaminsky knew all the details of the transactions between Loureinski and Karker, including Loureinski's intention to offset the \$800 against the note. Kaminsky, although he had knowledge of these facts, had no part in the proceedings. He took the note from a holder in due course in payment of a genuine debt. While he was not a holder in due course, he had all the rights of one because he obtained the note from a holder in due course. He was able to collect. The maker, Loureinski, could not complain because under any circumstances he would have had to pay Littlepaige, a true holder in due course. It was no less burdensome to pay Kaminsky.

**Obligations of the Holder.** When one becomes the holder of a negotiable instrument by indorsement, he can look to the maker or acceptor for payment, or he can look to the indorser or indorsers. His right to look to the maker of a note or the acceptor of a draft may be dependent upon whether or not he is a holder in due course. But even should he establish this status, he might not be able to collect. The maker may be bankrupt; in this case his right is of small value. In this event he will want to look to the indorsers. He can do so only if he has complied with the conditions which they imposed upon him at the time of their indorsement. These conditions are:

(1) To present all bills of exchange for acceptance when their form requires an acceptance, and to present all notes and accepted bills of exchange for payment.

(2) To notify all indorsers and drawers if the instrument is dishonored through failure of acceptance or failure of payment.

**Presentment for Payment or Acceptance.** A note or a draft need not be presented to the maker or acceptor for payment in order to hold him personally liable for payment. His promise to pay is unconditional, and the holder does not lose the right to receive payment because he neglects to demand payment so long as his right is not barred by the Statute of Limitations. Presentment is necessary in order to hold the drawer and the indorser. The holder must present the instrument on the day it is due to the one primarily liable (the maker of a note or the acceptor of a draft). Not only must he present it and demand payment on the day due, but he must do so at a reasonable hour of that day, or the next regular business day if the due date is Saturday, Sunday, or a holiday, and at the proper place. If the place of payment is named in the instrument, that is the proper place. Otherwise, it may be presented at the maker's or the acceptor's place of business, or at his residence, or, failing this, wherever he may be found. The holder will not be discharged from this obligation lightly. A failure to present a negotiable instrument at the place and in the manner specified by law must be due to factors beyond the control of the holder.

**Notice of Dishonor.** If a negotiable instrument has been dishonored by nonacceptance or nonpayment, notice of this dishonor must be given to the drawer and to each indorser. The drawer or any indorser who has not been given notice will be discharged from liability. Notice is not required if the instrument is nonnegotiable.

The notice of dishonor for domestic instruments is not required to be in any special form; it may be in writing or it may be oral. The only requirement is that the notice must identify the instrument sufficiently and must indicate that it has been dishonored by nonacceptance or nonpayment.

The notice of dishonor must be given within a reasonable time. It may be given personally or by mail. If the

**THE H. W. MONROE CO.**

255 Mission Street  
San Francisco, California

January 25, 19

Mr. W. J. Cronin  
842 Golden Gate Avenue  
San Francisco, Calif.

Please take notice that a check, of which the following  
is a copy,

San Francisco, Calif., January 10, 19

FIRST NATIONAL BANK

Pay to the order of Martin B. McMasters- - - - - \$78.00  
Seventy-eight and 00/100- - - - - Dollars

No. 138

(Signed) Robert N. House

and bearing the following indorsements:

Pay to Andrew L. Steele  
or order  
Martin B. McMasters

Andrew L. Steele

Pay to the order of  
The H. W. Monroe Co.  
W. J. Cronin

has been dishonored by nonpayment, and we look to you for  
payment.

THE H. W. MONROE CO.

*J. S. Burke*  
Credit Dept.

**A Notice of Dishonor.**



parties live in the same place, notice of dishonor must be given before the end of the day after the day of dishonor. When the parties live in different places, notice by mail must ordinarily be posted not later than the day after the day of dishonor. Proper mailing of the notice constitutes due notice, even if the notice is lost in the mail.

Range was the holder of a check drawn by Pate and indorsed by Sawyer and Cross. The check was dishonored for nonpayment. Range gave notice of dishonor orally to Sawyer and an unsigned written notice to Cross. Both parties attempted to avoid payment because of improper form of the notice. Neither defense was good. A formal notice, although recommended, was not required. Had this been a foreign bill of exchange, a written notice of protest would have been required.

**Protest.** Notice of dishonor must sometimes be in the form of a protest. A *protest* is a formal declaration made in writing by a notary public in behalf of the holder of a negotiable instrument, attesting that it has been presented for acceptance or payment and that acceptance or payment was refused. The certificate of protest, signed and sealed by the notary, is accepted as evidence of the facts of presentment, demand, nonacceptance or nonpayment, and notice of dishonor. A protest must ordinarily be made on the day and at the place of dishonor.

Any negotiable instrument may be protested at the election of the holder. While it is not necessary to protest inland or domestic bills of exchange, such bills may be protested. Foreign bills of exchange (including checks), however, must be protested for nonacceptance or nonpayment. If a foreign bill is not protested, the drawer and the indorsers will be discharged from liability for payment.

The certificate of protest must be attached to the protested instrument or must contain a copy of the instrument. It must specify:

- (1) The time and the place of presentment.

(2) The fact that presentment was made and the manner in which it was made

(3) The demand made and the answer given, or the fact that the maker or the acceptor could not be found

(4) The cause of or the reason for the protest

Copy of Protested Instrument, and of its Indorsements (Words erased and supplied as the facts required.)	<u>\$25.88</u>	<u>COLUMBIA, S. CAR., May 28, 19</u>	<u>7 9</u>
	<u>after</u>		<u>promise to</u>
	pay to the order of <u>L. C. Baldwin</u>		
	<u>Twenty-five 88/100</u> ----- <u>Dollars,</u>		
	payable at -----		
	Value received, and charge the same to the account of -----		
	To <u>SOUTH CAROLINA NATIONAL BANK</u>		
	<u>COLUMBIA, SOUTH CAROLINA</u> } <u>M. R. FRENCH</u>		
	Indorsements: <u>Pay to Peoples First National Bank for deposit, L. C. Baldwin, Charleston, South Carolina. - Pay to the order of any bank or banker, Peoples First National Bank. All prior indorsements guaranteed</u>		
	<p><b>United States of America, State of <u>SOUTH CAROLINA</u>, County of <u>RICHLAND</u>, ss.</b></p> <p><b>Be it Known by this Instrument of Protest, That at the close of banking<sup>1</sup> hours on</b></p> <p><b>the <u>first</u> day of <u>June</u> A. D. 19 <u>19</u> <u>J. H. J. Stevenson</u></b></p> <p><b>a NOTARY PUBLIC within and for said County of <u>Richland</u>, Did. at the request of</b></p> <p><b>the <u>South Carolina National Bank</u></b></p> <p><b>holder of the original <u>check</u> hereto attached and copied above, PRESENT the same to</b></p> <p><b>the <u>South Carolina National Bank</u></b></p> <p><b>and DEMANDED PAYMENT<sup>2</sup> thereof, which was REFUSED, for the following assigned reason:-----</b></p> <p style="text-align: center;"><b>NOT SUFFICIENT FUNDS</b></p> <p><b>I then PROTESTED the same for non-payment<sup>2</sup> and NOTIFIED the following named drawer and indorser --</b></p> <p><b>thereof of said presentment and protest, by a separate notice to each, enclosed in<sup>3</sup> <u>separate</u> envelopes.</b></p> <p><b>and address as follows: <u>M. R. French, Columbia, S. Car., L. C. Baldwin, Charleston, S. Car., and Peoples First National Bank, Charleston, S. Car.</u></b></p> <p>-----</p> <p><b>and deposited the same in the post office of <u>Columbia</u> in said county, the same day, postage paid; and the following-named drawer and indorser thereof, by delivering to each of them such notice personally on the same<sup>4</sup> day:-----</b></p> <p>-----</p> <p><b>Whereupon, I, the said notary, upon the authority aforesaid, have PROTESTED, and do hereby solemnly PROTEST, as well against the drawer of the said <u>check</u> as against all other persons whom it doth or may concern, for exchange, re-exchange, and all costs, charges, damages and interest, suffered, or to be suffered, for the want of payment<sup>2</sup> thereof, and I certify that I have no interest in the above protested instrument.</b></p> <p><b>Witness my hand and notarial seal this <u>first</u> day of <u>June</u> 19 <u>19</u></b></p> <p><b>Protest No. <u>2537</u></b></p> <p><b>Protest Fees, \$ <u>1.62</u></b></p> <p style="text-align: right;"><u>H. J. Stevenson</u> Notary Public</p>		


1. Or business, or otherwise, state when, as may be. 2. Or acceptance, if so. 3. The number of separate, as may be. 4. Or next, as may be. See Act. § 2116, 79 O. L. B. 83

### A Certificate of Protest.

**Notice of Protest.** Notice of the protest must be given to the parties not later than the day following the pro-

test. No special form of notice is necessary. Any notice that informs the parties of the demand and the non-acceptance or the nonpayment is sufficient. The drawer or the indorser to whom notice of the protest is not given is ordinarily discharged from liability unless he has waived notice of protest.

It should be remembered, however, that the instrument may contain a clause in which the drawer and the indorsers waive presentment, notice of dishonor, protest, and notice of protest. As a general rule, one may con-

<b>The State of</b> SOUTH CAROLINA		RICHLAND <b>County, ss.</b>
Take Notice, that a check		Columbia, June 1, 19
dated May 28, 19		for \$25.88
drawn by M. R. French		
in favor of L. C. Baldwin		
on the South Carolina National Bank		
<del>accepted by</del>		
indorsed by L. C. Baldwin and the Peoples First National Bank		
was this day presented for payment		which was refused, and therefore was this
day Protested, by the undersigned Notary Public, for non payment		
The holder therefore looks to you for payment thereof, together with interest, damages,		
costs, etc., you being payee		
To L. C. Baldwin, Charleston, S. Car.		 Notary Public

#### A Notice of Protest.

tract to forego all the civil rights which the law has established for his protection.

By way of summary, notice of dishonor follows this order:

If either acceptance or payment is refused, notice of dishonor is given by the holder to the indorsers and the drawer. This notice is called a notice of dishonor, if it is informal, that is, oral, or a written memorandum or letter. If the dishonor is certified to before a notary public, a certificate of protest is prepared and this is fol-

lowed by a notice of protest. The certificate of protest and the notice of protest must both be written. The notice of protest is mailed to the indorsers and the drawer.

### QUESTIONS AND PROBLEMS FOR DISCUSSION

1. Name the four conditions that constitute one a holder in due course.
2. Is a check which has the payee's name crossed out and a new payee's name written over it complete and regular on its face?
3. If one takes a time draft on the day it is due, is he a holder in due course, assuming he meets all other requirements?
4. Prosperi purchased a time draft from Cook for \$300, the face of the draft being \$500. The draft was not due at the time. Prosperi, in addition to the \$300, gave Cook a football which Cook had thrown for a winning touchdown in a very important football game. Prosperi knew that Cook wanted the football desperately to show to his four sons. The acceptor of the draft refused to pay the draft when it came due, claiming that Cook owed him \$600. Was Prosperi able to collect?
5. If a negotiable instrument falls due on Saturday, when should it be presented for payment?
6. Adam Burke was in charge of the credit department of the Baker Department Store. A customer indorsed a check for \$400 to the store in payment of a purchase. The check was dishonored when presented for payment. Burke laid the check aside for three or four days due to the rush of business before notifying Day, the indorser, that the check had been dishonored. The department store was never able to collect the check because Day was released by the delay in receiving notice. The department store sued Burke for the loss. Was Burke personally liable?
7. Explain the difference between a notice of protest and a certificate of protest.
8. Hipp, through fraud, induced Rocco to draw a draft on Hartman in favor of Hipp for \$250. Hipp indorsed the draft to Morocco, an innocent purchaser. Morocco later sold the

draft to Grant who knew of the fraud but was in no way a party to the fraud. When the draft became due, payment was refused because of the fraud. Did Grant have the privileges of a holder in due course?

9. Cohen, Cook, and Stacy were indorsers on a check in that order. The check was dishonored for nonpayment and the holder notified Cohen and Cook of the dishonor but did not notify Stacy. Did Stacy's release also release Cohen and Cook?

10. When Fanger presented for payment a promissory note that he held, payment was refused. Fanger immediately telephoned to Emmons, the indorser, identified the note, and told Emmons that the instrument had been dishonored by nonpayment. When Emmons was sued for the amount of the note, he contended that he was discharged from liability because he had not received written notice of the dishonor. Was Emmons' contention correct? Explain.

11. An indorser added his address to his indorsement. Notice of dishonor was delivered to him at this address while he was away from home on a vacation. Did this notification constitute proper notice?

12. Within what time must notice of protest be given?

13. Owen, of Kansas City, drew a bill of exchange on Krause, of New Orleans. When the instrument was not paid, the holder immediately wrote Owen that payment had been refused. When the holder sued Owen for the amount of the bill of exchange, Owen contended that the draft should have been protested. Do you agree with Owen? Why?

14. Norcross, the holder of a foreign bill of exchange, presented the instrument for acceptance, but acceptance was refused. Norcross then had the instrument protested at the place and on the day of dishonor. Was the responsibility of the drawer and the indorsers of this bill of exchange fixed by this protest? Explain.

## CHAPTER XXV

### DEFENSES

*"The knowledge of smatters is mixed ignorance."*

**FOREWORD.** A defense is a reason which one gives for failing to carry out his part of a contract. The court will not hear any defense which one wishes to make. It must be both relevant and valid. This chapter sets out what defenses are permissible against a holder in due course. Will the court permit one to introduce witnesses to prove a lack of consideration? to prove forgery? There is no point in permitting a party to come into court with witnesses to establish a defense if it would not release him from liability if proved true. After the court accepts the defense as admissible, the party making the defense must prove that it is true.

**Who May Make a Defense?** There are both immediate and remote parties to negotiable instruments. The immediate parties to a note are the maker and the payee, and the remote parties are the indorsers. All the indorsers are liable on the note, and all of them may make a defense against paying it. In the case of a draft, the drawer, the payee, and the drawee, who later becomes the acceptor if it is a time draft, are the immediate parties. When the draft is accepted, the drawer assumes the legal status of an indorser if the draft is payable to a third party. The maker of a note and the drawee or acceptor of a draft are the ones from whom the holder will first demand payment. If they refuse, then the holder demands payment of all indorsers. We will discuss first the defenses which the maker or the acceptor may make against the holder.

**Personal Defenses and Real Defenses.** The defenses which the maker or the acceptor may make against the holder are classed as personal and real. If the holder is not an innocent purchaser or a holder in due course,

either a real or a personal defense will bar recovery. He has no more privileges or immunities than the original payee. If he is a holder in due course, or derives his title through a holder in due course, however, all personal defenses are of no avail against him. He takes the instrument free from all personal defenses. The real defenses, however, are good against the whole world. If established, they are a complete bar to recovery regardless of one's status as a holder in due course.

**Personal Defenses.** The most common personal defenses which are good against all holders except holders in due course are:

(1) *Duress.* Duress is the act of obtaining one's consent to a contract by force or by the threat of force.

(2) *Undue Influence.* Undue influence is a form of mental coercion or pressure brought to bear through the close personal relationship existing between the contracting parties.

(3) *Misrepresentation.* Misrepresentation is an innocent misstatement or concealment of a material fact.

(4) *Nondelivery of a Completed Instrument.* If an instrument is stolen, lost, or otherwise wrongfully taken after it is completely filled out but before it is delivered by the maker or the drawer, delivery is not considered to have been made. Nondelivery is a personal defense, and the instrument is therefore collectible in the hands of a holder in due course but not in the hands of others.

(5) *Fraud.* Fraud relating to the formation of a negotiable instrument is a personal defense not good against a holder in due course. We shall observe later that fraud that results in a mistake as to the nature of the agreement signed renders the agreement void and is therefore valid against all holders.

Crane offers to sell Yardley his car for \$500 and states that the car just recently had a complete overhauling of the engine and transmission. Yardley, relying upon this false statement, accepts the offer to his detriment.

Crane suggests that Yardley sign a memorandum of the agreement pending final consummation of the sale. Crane, by trickery, substitutes a negotiable note for \$1,000 which Yardley signs.

In the above illustration there was fraud in the actual sale which preceded the signing of the instrument. This type of fraud is a personal defense and is of no avail against a holder in due course. The other type of fraud is covered under (4) of Real Defenses, page 245.

(6) *Lack of Consideration.* Negotiable instruments, like all other contracts, must be supported by a consideration. In the hands of a holder in due course consideration is presumptive. A note made as a gift cannot be collected by court action by the original holder, but a holder in due course can collect it.

(7) *Payment or Part Payment.* If the maker of a note or the drawee of a draft pays the full amount of the instrument, or any part of it, before maturity and, because of carelessness or neglect, fails to see that the proper indorsement is made on the instrument, he may be compelled to pay the instrument a second time. If the instrument is acquired by a holder in due course after such a payment without the proper notation having been made, the defense of payment will not be good against that holder. A receipt for the payment will not be sufficient.

The maker of a promissory note wished to pay it before it was due. The payee told the maker that the note was destroyed and gave the maker a receipt for the money paid. The payee had, however, previously negotiated the note to a holder in due course. The court held that the maker was obliged to pay it the second time.

(8) *Setoff and Counterclaim.* If the acceptor of a trade acceptance given for the purchase of merchandise later returns a part of the merchandise, he has a right of setoff against the seller. This right is lost, however, if the seller transfers the instrument to a holder in due



course. A counterclaim differs from a setoff in that the reduction claimed is due to a separate contract. For example, Tonne buys merchandise from Larson valued at \$500 and later sells Larson merchandise valued at \$100. He has a counterclaim against Larson for \$100. If Tonne gave Larson a negotiable note for \$500 and Larson transferred it to a holder in due course, Tonne could not make his counterclaim against the holder in due course.

The one thing which makes this group of defenses peculiar to negotiable instruments is that they will not suffice to bar recovery even if true when made against an innocent purchaser. We have already discussed most of them in preceding chapters and found that any one of them renders a contract except a negotiable contract voidable. It is this feature which gives negotiable contracts their privileged status among all other contracts. There are three links in the chain: the contract must be negotiable; the holder must be an innocent purchaser; the defense must be personal.

**Real Defenses.** Real defenses are defenses of a somewhat unusual character that concern not the merits of the transaction, but rather the nature of the instrument itself. They are sometimes called absolute defenses because they are good against even a holder in due course. They are:

(1) *Personal Incapacity to Make an Enforceable Contract.* This defense relates to infants, insane persons, and all other persons legally incompetent to contract.

(2) *Illegality.* If statutes have declared certain instruments void, no enforceable rights under them can be acquired against the maker, drawer, or acceptor. This rule applies especially when statutes have declared void negotiable instruments given in payment of gambling transactions. General indorsers of such instruments must pay damages for breach of the warranty of validity.

(3) *Forgery and Alteration.* A forgery is an absolute defense. It is quite evident that a person cannot be com-

pelled to pay a negotiable instrument that he did not sign. If a material alteration has been made in a negotiable instrument, the party who made the alteration will not be permitted to recover. A holder in due course who received the instrument after it was altered may recover the amount due on the original instrument. A material alteration is one that affects:

- (a) The sum payable, either principal or interest.
- (b) The time, the place, or the date of payment
- (c) The number or the relationship of the parties

(4) *Fraud in the Inception.* Fraud in the inception, which is one of the mistakes that render an agreement void, is a real defense and exists when a person is induced by fraud, without negligence on his part, to sign a negotiable instrument that he believes is an instrument of some other character. Since the party primarily liable has no intention of creating a negotiable instrument, none is created.

Westfall agreed to sign a contract for the purchase of a car from Gatefsky. Gatefsky used a trick type of paper which contained the correct terms of the contract to sell. The paper was such that when the true contract was lifted up, it revealed a note for \$5,000 and the signature of Westfall was to the note, not the contract to sell. This was fraud in the inception or execution and constituted a real defense, good against the whole world, provided the maker was not negligent. When a trick or device such as this is used, there is no negligence if an ordinary person could not detect the trick.

(5) *Lapse of Time under a Statute of Limitations.* This defense relates to instruments that have been outlawed by the expiration of a statutory period.

(6) *Nondelivery of an Incompleted Instrument.* If the negotiable instrument is incomplete and is not delivered, no contract is ever formed and even a holder in due course cannot collect. To be an absolute defense, the instrument must be both incomplete and nondelivered.

If it is incomplete but still is actually delivered, the defense is personal, not absolute.

If the maker or the drawer of a negotiable instrument that is incomplete—that is, one on which blanks have been left—delivers it to another, he gives the holder implied authority to fill in the blanks and to complete the instrument in accordance with his directions. The signer is bound on the instrument if the blanks are filled in accordance with the authority given. The signer is liable even though the instrument was completed in a manner contrary to his directions, however, if the instrument is negotiated to a holder in due course.

(7) *Usury.* Usury is charging an interest rate in excess of the maximum rate fixed by law. The law on this point is not uniform, but in most states usury at the inception of the note is a real defense. New York makes an exception to this rule in the case of banks. If a bank accepts a negotiable instrument under conditions which make it a holder in due course, usury at the inception of the instrument is a personal defense, not a real defense.

(8) *Mistakes Which Render a Contract Void.* In Chapter V, pages 41 to 43, we discussed the mistakes that render a contract void. These mistakes made in the execution of a negotiable contract constitute a good defense against even a holder in due course.

**Defenses of the Indorsers.** All the preceding discussion of defenses relates only to the defenses which the maker of a note or the acceptor of a draft may make against a holder in due course. When the holder presents a negotiable instrument for payment and is refused, his next step is to demand payment from the indorsers. He can demand payment from them, either individually or jointly, regardless of the reason which the maker or the acceptor may give for not paying it. One or more of the indorsers, however, may have a tenable defense to make. This fact is illustrated on the following page.

On June 26, 19—, I promise to pay to John Doe or order \$500.

Richard Rowe

This note was indorsed as follows:

Pay to the order of Adam Smith.

John Doe

Pay to the order of Henry Ratcliffe.

Adam Smith

Pay to the order of Bernard Funk.

Henry Ratcliffe

On June 26, 1950, Bernard Funk presents the note to Richard Rowe for payment, and payment is refused. Funk can now look to any one or all of the indorsers for payment. To do this, however, he must have the note duly protested, and notice of dishonor and protest must be given to each of the indorsers. Let us assume that Ratcliffe reimburses Funk. He, Ratcliffe, then demands and receives payment from Smith; and Smith in turn goes back to Doe for reimbursement.

If Funk serves notice of dishonor, or notice of protest on Ratcliff only, then Ratcliff, in order to preserve his right to proceed against Smith and Doe should give notice to them. If Funk gives the notice to Smith and Doe, Ratcliff need not do so.

If we assume the same facts except that Funk gave Doe and Smith notice of dishonor and protest but not Ratcliffe, then Ratcliffe would be the one to plead no notice as a defense. This would be a good defense for him, but it would not release Smith and Doe from liability since their rights were in no way jeopardized by Funk's failure to give notice to Ratcliffe.

The instrument may provide for a waiver of presentment for payment as well as protest and notice of dishonor and protest by the maker and all indorsers. In such event, the law as described above would not apply.

IS THE INSTRUMENT NEGOTIABLE?	IS THE PARTY A HOLDER IN DUE COURSE?	WHAT IS THE NATURE OF THE DEFENSE?
<p>The instrument must:</p> <ol style="list-style-type: none"> <li>(1) Be in writing and signed by the party executing it.</li> <li>(2) Contain an order or a promise to pay.</li> <li>(3) Make the order or the promise unconditional.</li> <li>(4) Provide for the payment of a sum certain in money.</li> <li>(5) Be payable on demand or at a fixed or determinable future time.</li> <li>(6) Be payable to the order of a payee or to the bearer of the instrument.</li> <li>(7) Designate the payee and the drawee with reasonable certainty.</li> </ol>	<ol style="list-style-type: none"> <li>(1) The instrument must be complete and regular on its face.</li> <li>(2) It must not be past due at the time of the negotiation.</li> <li>(3) The holder must take the instrument in good faith and for value.</li> <li>(4) The holder must have no notice of any infirmity in the instrument or any defect in the title of the person who negotiated it.</li> </ol>	<p><i>Personal defenses:</i></p> <ol style="list-style-type: none"> <li>(1) Duress.</li> <li>(2) Undue influence.</li> <li>(3) Misrepresentation.</li> <li>(4) Nondelivery of a completed instrument.</li> <li>(5) Fraud.</li> <li>(6) Lack of consideration.</li> <li>(7) Payment or part payment.</li> <li>(8) Setoff and counterclaim.</li> </ol> <p><i>Real defenses:</i></p> <ol style="list-style-type: none"> <li>(1) Personal incapacity to contract.</li> <li>(2) Illegality.</li> <li>(3) Forgery and alteration.</li> <li>(4) Fraud in the inception.</li> <li>(5) Lapse of time under a statute of limitations.</li> <li>(6) Nondelivery of an incomplete instrument.</li> <li>(7) Usury.</li> <li>(8) Mistakes which render a contract void.</li> </ol>

Some of the Most Important Features of the Law of Negotiable Instruments.

If notice of dishonor and protest is impossible, and the holder exercises all due diligence in an effort to give notice, then a failure to receive the notice is not a good defense. The last indorser is known to the holder, but his address may be unknown. The holder may not know any of the other indorsers or their addresses. In this event he is required only to use due diligence in trying to notify them.

**Summary.** For a holder to invoke the protection of the Negotiable Instruments Law, he must first ask, Is the instrument negotiable? If it is, he must next prove he is a holder in due course. Finally, he must ask, What is the nature of the defense? If the instrument is negotiable and he is a holder in due course, then all personal defenses are barred. If the defense is a real defense, it is wholly immaterial whether or not the contract is negotiable, or whether he is a holder in due course. The contract must stand solely on its merits the same as any other contract.

### QUESTIONS AND PROBLEMS FOR DISCUSSION

1. Why is it necessary to distinguish between real and personal defenses?

2. Cooper leased a house for one year to Runey for \$90 a month. Runey was to sign the lease in triplicate. Through a clever device one of the signatures was made on a note for \$5,000. Cooper then sold the note to Chavez, an innocent purchaser. When the note came due, Runey refused to pay, claiming fraud. Was this a good defense against an innocent purchaser?

3. (a) Is a note made as a gift collectible as between the primary parties?

(b) Would your answer be different if the note was transferred to an innocent purchaser?

(c) Maelstrom gave Jackson the following note:

Ninety days after date I promise to pay J. Jackson or order \$500 or 300 bushels of wheat at my option.

Signed: A. Maelstrom.

Before maturity Jackson sold the note to Davis for value. When Davis demanded payment Maelstrom refused payment contending that he had already paid Jackson. Was this a valid defense?

4. Tatum, a young man twenty years of age, gave the Lamont Motor Company some cash and a note for the purchase of an automobile. The Lamont Motor Company transferred the note to a finance company. When the note became due, Tatum refused to pay, claiming infancy as a defense. Was this a good defense? Why?

5. Hertz, a young man twenty years of age, gave Olson a promissory note payable two years after date.

(a) Might Hertz repudiate this note before he became of age?

(b) Might Hertz repudiate it after he became of age?

(c) When Hertz became of age, would his silence act as a ratification?

6. Larkin forged Fisher's name as the maker of a promissory note. Larkin negotiated the note to Dakin, who was a holder in due course. When the note was due, Dakin demanded payment from Fisher. Could Dakin hold Fisher liable? Explain.

7. Garrett gave Brooks the following note:

December 15, 19—
60 days after date I will pay E. Brooks, or another party if he so orders, \$500.
A. Garrett

Brooks induced Garrett to give him this note through fraud. He sold the note to Smith, an innocent purchaser. Smith, in turn, sold it to Jones who knew of the fraudulent nature of the transaction, but was not himself a party to it. Jones sued Garrett for the note, and Garrett attempted to plead fraud as a defense. Would the court permit him to offer this defense?

8. Davis filled out a note payable to Mullins. It was completed in every respect except that the amount was omitted pending a determination of the exact amount. Mullins stole the note, filled in the amount spaces for \$1,000 and then sold it to Fortune, an innocent purchaser. Could Fortune collect the note from Davis?

What would your answer be if it had been completed before Mullins obtained possession of it?

9. Allen signed a note on June 1 payable on demand for \$100 at ten per cent interest. The maximum rate of interest in that state is six per cent and the penalty for usury is rendering the whole contract null and void. On December 1, Dodge, the payee, sold the note to Ford for value. Allen refused to pay the note on demand. Ford waited one month and then notified Dodge that the note had been dishonored. He later sued both Allen and Dodge for the value of the note. What defense, if any, could either defendant offer?

10. Miller gave Estep the following note:

January 2, 19—

60 days after date, or sooner if I can sell my wheat, I will pay James Estep or anyone else he may designate \$500.

Robert Miller

Estep obtained this note from Miller by threatening to have him indicted for forgery. Miller was innocent; but to avoid the scandal and worry, he signed the note. Ten days after its date Estep sold the note to Thomas Hall for \$200 in cash and a secondhand car worth about \$100. Hall knew that Estep had never owned a car and was not a very good judge of value. When Hall demanded payment of Miller, Miller refused to honor the note. Hall brought suit. State what bearing each item of evidence had upon the case and give your own conclusion.

11. A trade acceptance in negotiable form was drawn by Cable and accepted by F. C. Wields. Before maturity it was indorsed by the following people:

Harry Cable  
Bart Creegar  
John McCoy  
James Stevens

When the instrument came due, William Howland, the holder, notified Stevens and Cable of the dishonor but failed to notify Creegar and McCoy. Howland brought suit against all four indorsers and the acceptor. Discuss the liability of each of the defendants.



12. If a note waives notice of protest, is the waiver binding upon the maker?

13. Is a failure to give notice of dishonor and protest ever excused?

14. What should the holder of a negotiable contract do if the present address of the last indorser is unknown?

## CASES

*(Summarizing Part V)*

1. Stevens executed the following contract:

New York, Aug. 17th, 1865. I certify that James Smilie, Jr., has deposited with me five hundred dollars, payable to his order on demand with interest from February 15, 1864, on the return of this certificate and my guarantee of his note to his brother, John Smilie, dated February 15, 1864, for the sum of five hundred dollars.

Simon Stevens

This contract was sold for value to an innocent purchaser. Stevens contended that the contract was not negotiable in form, and therefore he could raise personal defenses even against an innocent purchaser. (Smilie vs. Stevens, 39 Vt. 315) Was the contract negotiable?

2. Robbins executed a negotiable promissory note payable to Angie Daggett. Robbins did not deliver the note to Daggett but instead gave it to Hattie Ray, her own maid, to hold pending her directions as to delivery. Before the note was ever delivered to the payee, Daggett, the maker died. After the maker's death, Hattie Ray delivered the note to Daggett. Simonds, the executor of Robbins's estate, refused to pay the note on the ground there had never been a true delivery. (Daggett vs. Simonds, 53 N. E. 907) Was there ever a legal delivery?

3. Emmons Davis executed the following note:

"For value received, I promise to pay to Elizabeth Gamble, or order, the sum of \$1,500 in twelve months after I shall become the legal owner of one hundred

and fifteen acres of land conveyed to me by my father, H. V. Davis, reserving to him, H. V. Davis, a life estate in said land.

Emmons Davis

Gamble indorsed this note to McClenathan, an innocent purchaser. At the time the note was made Emmons Davis was absolutely certain to obtain title to the real estate although he did not have title at that time. Emmons Davis contended that the note was not payable at a definite and determinable future time, and therefore it was not negotiable. (McClenathan vs. Davis, 243 Ill. 87) Was this note negotiable?

4. Keel and Hoover executed a note to Day. The date of the note was erroneously omitted and the bank subsequently filled in the date, December 30, when actually the true date was December 1. Day, as an indorser, claimed that he was released from liability because of this improper date. (Bank of Houston vs. Day, 145 Mo. App. 410) Do you agree with Day?

5. Frank and Sophie Jackson executed a promissory note in favor of George Tribble. Sophie Jackson being unable to write, signed her name by a mark. When Tribble sued on the note, the Jacksons contended they were not liable because the notes were not properly signed. (Jackson vs. Tribble, 156 Ala. 480) Do you agree?

6. Principal executed a note in favor of Hallembeak for \$3,500. The note was regular and negotiable in every particular except that it contained this clause:

"This note is secured by a purchase money mortgage on 160 acres of land in Guthrie County, Iowa, and payee herein agrees to look to mortgagee as security for payment of this note."

Allison became the holder of this note as an innocent purchaser. On a suit to collect, the decision hinged on whether or not the note was negotiable in form. (Allison vs. Hallembeak, 138 Iowa 479) What is your opinion?

7. Johnson Buford drew a draft on John H. Crutchfield for \$202, payable to Jasper S. Martin. The draft was duly accepted when presented. When Martin brought suit against Crutchfield, the latter raised as a defense the fact that the drawer was a minor. (Crutchfield vs. Martin, 27 Okla. 764) Was this a valid defense?

8. Linnick signed his name to a blank check and later the incompleated check was stolen, the blank spaces filled in, and then indorsed over to Nutting & Company. Nutting & Company later cashed the check. Linnick sued Nutting & Company for reimbursement on the ground that they never had rightful title to the check. (125 N. Y. S. 93) Do you agree?

9. Clukey was the treasurer of the Belgrade Silver Black Fox Ranch Company. In this capacity it was his duty to draw checks on the company's bank account. He drew checks without authority on the company's account, payable to a personal creditor. One of these checks was to the Lewiston Trust Co. to whom he owed money. Later the Belgrade Silver Black Fox Ranch Company went bankrupt and the receiver sued the bank for a return of this money. (Boyle vs. Lewiston Trust Company, 126 Me. 74) Was the trust company a holder in due course?

10. Easley was the holder by negotiation of a certificate of deposit payable on demand, with a provision that no interest would be paid after twelve months. Easley acquired the certificate considerably more than a year after its date. (Easley vs. East Tennessee National Bank, 138 Tenn. 369) Was Easley a holder in due course?

11. Samuel and Annie Jacobson executed a promissory note for \$4,500, payable to Frank and Angelo Sarandrea. At the time of executing the note the Jacobsons lived in apartment 55 A of an apartment house of several apartments. The Sarandreas sold the note to Luis J. Cuddy and his wife. When the note became due, it was placed with Edwin C. and Henry Potter for collection. The Jacobsons moved before maturity and left no address. The Potters, not being able to find the makers to present the note for payment, notified the indorsers of the nonpayment. The indorsers contended that the holders did not make proper presentment. (Cuddy vs. Sarandrea, 52 R. I. 465) Do you agree?

12. Hall had very poor eyesight and had to rely upon someone to read for her. She was asked to sign a note in favor of Ferguson and Barnes. She never intended to sign this particular note, but through the fraud of her own attorney, she signed the note not realizing it was a note she was signing. The note was later sold to the First National Bank, a holder in due course. Hall refused to pay on the

ground of fraud. (First National Bank vs. Hall, 169 Iowa 218) Was Hall liable on the note?

13. During Wright's absence from his office, a thief appropriated a note made payable to bearer. The thief negotiated the note to Clark for value. (54 Ill. 296) When the note was due, would Wright be obliged to pay Clark?

14. Bullock fraudulently induced Costello to make a note payable to Bullock's order. Bullock transferred the note to Ratcliff, a holder in due course. Ratcliff immediately sold the note to his father, and later repurchased it. At the time he repurchased the note, Ratcliff had notice of the fraud. (117 Va. 563) Would Costello have a good defense if he set up the fraud of Bullock as a defense to the suit brought by Ratcliff?

15. Under the laws of Kentucky a bet or a wager is said to be "vicious, illegal, and void." In that state a note was given in payment of a gambling debt. The note was transferred to a holder in due course. (123 Ky. 677) Would the holder in due course be permitted to collect the note from the maker?